

## LIMITED OFFERING MEMORANDUM

### NEW ISSUES—BOOK-ENTRY ONLY

**RATING: Standard & Poor's: "BB"**

*In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Authority, based upon an analysis of existing laws, regulations, rulings and court decisions and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2014A Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, and interest on the Bonds is exempt from State of California personal income taxes. In the further opinion of Bond Counsel, interest on the 2014A Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel expresses no opinion regarding any other tax consequences relating to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Bonds. See "TAX MATTERS" herein.*

**\$6,020,000**

### **CALIFORNIA SCHOOL FINANCE AUTHORITY SCHOOL FACILITY REVENUE BONDS**

**(MAGNOLIA SCIENCE ACADEMY-1, RESEDA PROJECT)**

**\$5,675,000**

**SERIES 2014A**

**\$345,000**

**SERIES 2014B (TAXABLE)**

**Dated: Date of Delivery**

**Due: July 1, as shown on the inside cover**

The California School Finance Authority (the "Authority") is issuing its School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project) Series 2014A, in the aggregate principal amount of \$5,675,000 (the "2014A Bonds") and its School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project) Series 2014B (Taxable), in the aggregate principal amount of \$345,000 (the "2014B Bonds" and, together with the 2014A Bonds, the "Bonds"), pursuant to an Indenture, dated as of June 1, 2014 (the "Indenture"), by and between the Authority and The Bank of New York Mellon Trust Company, N.A., as trustee (the "Trustee"). The Authority will make a loan of the proceeds of the Bonds to MPM Sherman Way LLC, a California limited liability company (the "Borrower" or the "Lessor"), pursuant to a Loan Agreement, dated as of June 1, 2014, by and between the Authority and the Borrower (the "Loan Agreement").

The Bonds are limited obligations of the Authority payable only out of certain revenues and other amounts held in certain funds established by the Indenture (except the Rebate Fund and the Repair and Replacement Fund). The Borrower will use the proceeds of the Bonds (i) to finance the acquisition, construction, expansion, remodeling, renovation, improvement, furnishing and equipping of the land and facilities located at 18238 Sherman Way, Reseda, California (the "Facility"), to be owned by the Borrower and leased to Magnolia Educational & Research Foundation, a California nonprofit public benefit corporation, also known as Magnolia Public Schools ("MERF" or the "Lessee"), for use and occupancy by Magnolia Science Academy 1, also known as Magnolia Science Academy (the "School"), pursuant to the Lease Agreement, dated as of June 1, 2014, between the Borrower and the Lessee (the "Lease"), (ii) to fund a deposit to the Repair and Replacement Fund (described herein), and (iii) to pay the cost of certain expenses incurred in connection with the issuance of the Bonds. MERF has received a determination letter from the Internal Revenue Service recognizing it as an organization described in Section 501(c)(3) of the Code. The obligations of the Borrower under the Loan Agreement are secured by an assignment of the rent payments received from the School under the Lease. See APPENDIX A – "CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION" herein.

Interest on the Bonds will be payable semiannually on each January 1 and July 1, commencing January 1, 2015. The Bonds are being issued as fully registered bonds and initially will be registered in the name of Cede & Co., as nominee for The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Bonds. Purchase of beneficial interests in the Bonds will be made in book-entry-only form (without physical certificates) in denominations of \$100,000 and any integral multiple of \$5,000 in excess thereof. For so long as DTC or its nominee, Cede & Co., is the registered owner of the Bonds, (i) payments of the principal of and premium, if any, and interest on such Bonds will be made directly to Cede & Co. for payment to its participants for subsequent disbursement to the Beneficial Owners, and (ii) all notices, including any notice of redemption shall be mailed only to Cede & Co. See APPENDIX E – "BOOK-ENTRY-ONLY SYSTEM" herein.

The Bonds are subject to optional, mandatory and extraordinary redemption prior to maturity as described under "THE BONDS – Redemption" herein.

**THE BONDS ARE TO BE OFFERED AND SOLD (INCLUDING IN SECONDARY MARKET TRANSACTIONS) ONLY TO APPROVED INSTITUTIONAL INVESTORS (DEFINED AS "QUALIFIED INSTITUTIONAL BUYERS" UNDER RULE 144A OF THE SECURITIES ACT OF 1933) (AS DEFINED IN REGULATION D OF THE SECURITIES ACT OF 1933). THE BONDS AND BENEFICIAL INTERESTS THEREIN MAY BE TRANSFERRED, UPON SATISFACTION OF CERTAIN CONDITIONS, INCLUDING EXECUTION AND DELIVERY OF AN INVESTOR LETTER IN THE FORM ATTACHED HERETO AS APPENDIX G, ONLY TO CERTAIN APPROVED INSTITUTIONAL BUYERS. SEE "NOTICE TO INVESTORS" AND "TRANSFER RESTRICTIONS."**

THE BONDS DO NOT CONSTITUTE A DEBT OR LIABILITY OF THE STATE OF CALIFORNIA OR OF ANY POLITICAL SUBDIVISION THEREOF UNDER THE INDENTURE, OTHER THAN THE AUTHORITY, BUT SHALL BE PAYABLE SOLELY FROM THE FUNDS PROVIDED THEREFOR UNDER THE INDENTURE. NEITHER THE STATE OF CALIFORNIA NOR THE AUTHORITY SHALL BE OBLIGATED TO PAY THE PRINCIPAL OF, OR THE REDEMPTION PREMIUM, IF ANY, OR INTEREST, EXCEPT FROM THE FUNDS PROVIDED THEREFOR UNDER THE INDENTURE AND NEITHER THE FAITH AND CREDIT NOR THE TAXING POWER OF THE STATE OF CALIFORNIA OR OF ANY POLITICAL SUBDIVISION THEREOF, INCLUDING THE AUTHORITY, IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF OR THE REDEMPTION PREMIUM, IF ANY OR INTEREST ON THE BONDS. THE ISSUANCE OF THE BONDS SHALL NOT DIRECTLY OR INDIRECTLY OR CONTINGENTLY OBLIGATE THE STATE OF CALIFORNIA OR ANY POLITICAL SUBDIVISION THEREOF (EXCEPT THE AUTHORITY, TO THE LIMITED EXTENT SET FORTH IN THE INDENTURE) TO LEVY OR TO PLEDGE ANY FORM OF TAXATION OR TO MAKE ANY APPROPRIATION FOR THEIR PAYMENT. THE AUTHORITY HAS NO TAXING POWER. NOTHING IN THE INDENTURE, THE ACT OR OTHERWISE IS AN UNDERTAKING BY THE AUTHORITY OR THE STATE OR ANY POLITICAL SUBDIVISION THEREOF TO FUND THE TRANSFERS DESCRIBED IN THE INTERCEPT NOTICE (DEFINED HEREIN) OR TO MAKE STATE APPORTIONMENTS OR OTHER FUNDS AVAILABLE TO THE SCHOOL IN ANY AMOUNT OR AT ANY TIME.

INVESTMENT IN THE SERIES 2014 BONDS INVOLVES A SIGNIFICANT DEGREE OF RISK AND IS SPECULATIVE IN NATURE AS DESCRIBED UNDER "RISK FACTORS" HEREIN AND OTHER SECTIONS OF THE LIMITED OFFERING MEMORANDUM.

*This cover page contains information for general reference only. It is not intended as a summary of these transactions. Investors are advised to read the entire Limited Offering Memorandum to obtain information essential to making an informed investment decision.*

The Bonds are offered when, as and if issued by the Authority and received by the Underwriter, subject to prior sale and approval of legality by Orrick, Herrington & Sutcliffe LLP, Bond Counsel and Disclosure Counsel to the Authority, the approval of certain matters for the Authority by its special counsel, Nixon Peabody LLP, and the approval of certain matters for the Borrower, the Sole Member and the Lessee by Musick Peeler & Garrett LLP, Los Angeles, California. Certain legal matters will be passed upon for the Underwriter by Eichner Norris & Neumann PLLC, Washington, District of Columbia, Underwriter's Counsel. It is expected that the Bonds in definitive form will be available for delivery through DTC in New York, New York, on or about June 26, 2014.

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**Honorable Bill Lockyer  
Treasurer of the State of California  
As Agent for Sale**

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**RBC CAPITAL MARKETS LLC**

Dated: June 18, 2014

## **MATURITY SCHEDULE**

**\$5,675,000**

**CALIFORNIA SCHOOL FINANCE AUTHORITY  
SCHOOL FACILITY REVENUE BONDS  
(MAGNOLIA SCIENCE ACADEMY-1, RESEDA PROJECT)  
SERIES 2014A**

\$660,000 5.25% Term Bonds Due July 1, 2024 – Price: 100% CUSIP No. 13059TAT6<sup>†</sup>

\$1,780,000 6.00% Term Bonds Due July 1, 2034 – Price: 100% CUSIP No. 13059TAU3<sup>†</sup>

\$3,235,000 6.25% Term Bonds Due July 1, 2044 – Price: 100% CUSIP No. 13059TAV1<sup>†</sup>

**\$345,000**

**CALIFORNIA SCHOOL FINANCE AUTHORITY  
SCHOOL FACILITY REVENUE BONDS  
(MAGNOLIA SCIENCE ACADEMY-1, RESEDA PROJECT)  
SERIES 2014B (TAXABLE)**

\$345,000 7.00% Term Bonds Due July 1, 2019 – Price: 100% CUSIP No. 13059TAW9<sup>†</sup>

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<sup>†</sup> CUSIP® is a registered trademark of the American Bankers Association. CUSIP Global Services (CGS) is managed on behalf of the American Bankers Association by S&P Capital IQ, a business line of McGraw Hill Financial, Inc. Copyright © 2014 CUSIP Global Services. CUSIP numbers are provided for convenience only and none of the Borrower, the Authority or the Underwriter takes any responsibility for the accuracy thereof.

## **NOTICE TO INVESTORS**

The Bonds are to be offered and sold (including in secondary market transactions) only to Approved Institutional Buyers (deemed as a “qualified institutional buyer” under Rule 144A of the Securities Act of 1933). The Indenture under which the Bonds will be issued contains provisions limiting transfers (except under certain limited circumstances described herein) of the Bonds to Approved Institutional Buyers. In addition, the face of each Bond contains a legend to the effect that such Bond may only be owned by Approved Institutional Buyers. In addition, the initial purchasers of the Bonds will be required to submit an investor letter in the form attached hereto as APPENDIX G to the Authority and the Trustee.

BY ITS PURCHASE OF ANY BOND, EACH APPROVED INSTITUTIONAL BUYER IS A PURCHASER OF ONE OR MORE BONDS WILL BE DEEMED:

1. TO HAVE EXPERIENCE IN THE BOND MARKET, HAVE KNOWLEDGE AND EXPERIENCE IN FINANCIAL AND BUSINESS MATTERS AND BE CAPABLE OF EVALUATING THE MERITS AND RISKS OF THE BONDS, AND ABLE TO BEAR THE ECONOMIC RISK OF ITS INVESTMENT IN THE BONDS, INCLUDING A TOTAL LOSS OF PURCHASER'S INVESTMENT;

2. TO REPRESENT THAT IT IS PURCHASING THE BONDS FOR ITS OWN ACCOUNT OR FOR THE ACCOUNTS OF ONE OR MORE APPROVED INSTITUTIONAL BUYERS FOR WHICH IT IS ACTING AS A FIDUCIARY OR AGENT, IN EACH CASE FOR INVESTMENT, AND NOT WITH A VIEW TO, OR FOR OFFER OR SALE IN CONNECTION WITH, ANY DISTRIBUTION THEREOF IN VIOLATION OF THE SECURITIES ACT OR OTHER APPLICABLE SECURITIES LAWS, SUBJECT TO ANY REQUIREMENT OF LAW THAT THE DISPOSITION OF ITS PROPERTY OR THE PROPERTY OF SUCH APPROVED INSTITUTIONAL BUYER BE AT ALL TIMES WITHIN ITS OR THEIR CONTROL AND SUBJECT TO ITS OR THEIR ABILITY TO RESELL SUCH BONDS TO PARTIES THAT THE PURCHASER DEEMS IN GOOD FAITH TO BE SUITABLE INVESTORS;

3. TO ACKNOWLEDGE THAT THE BONDS (A) HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT AND ARE NOT REGISTERED OR OTHERWISE QUALIFIED FOR SALE UNDER THE “BLUE SKY” LAWS AND REGULATIONS OF ANY STATE, (B) WILL NOT BE LISTED ON ANY STOCK OR OTHER SECURITIES EXCHANGE, AND (C) MAY NOT BE READILY MARKETABLE; AND

4. ACKNOWLEDGE THAT THE AUTHORITY, THE BORROWER, THE TRUSTEE, THE UNDERWRITER AND OTHERS WILL RELY UPON THE TRUTH AND ACCURACY OF THE FOREGOING ACKNOWLEDGMENTS, REPRESENTATIONS AND AGREEMENTS.

This Limited Offering Memorandum does not constitute an offer to sell the Bonds or the solicitation of an offer to buy, nor shall there be any sale of the Bonds by any person in any state or other jurisdiction to any person to whom it is unlawful to make such offer, solicitation or sale in such state or jurisdiction. No dealer, salesperson or any other person has been authorized to give any information or to make any representation other than those contained herein in connection with the offering of the Bonds, and, if given or made, such information or representation must not be relied upon.

The information set forth herein under the captions “THE AUTHORITY” and “ABSENCE OF MATERIAL LITIGATION — The Authority” has been furnished by the California School Finance Authority. All other information set forth herein has been obtained from the Borrower and other sources that are believed to be reliable. The adequacy, accuracy or completeness of such information is not guaranteed by, and is not to be construed as a representation of, the Authority or the Underwriter. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Limited Offering Memorandum, nor any sale made hereunder, shall under any circumstances create any implication that there has been no change in the affairs of the Authority, The Depository Trust Company or the Borrower since the date hereof.

The Underwriter has provided the following sentence for inclusion in this Limited Offering Memorandum: The Underwriter has reviewed the information in this Limited Offering Memorandum in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of these transactions, but the Underwriter does not guarantee the accuracy or completeness of this information.

The Authority has not reviewed any appraisal for the Project or any feasibility study or other financial analysis of the Project and has not undertaken to review or approve expenditures for the Project, to supervise the acquisition and renovation of the Project, or to obtain any financial statements of the Borrower.

The Authority has not reviewed this Limited Offering Memorandum and is not responsible for any information contained herein, except for the information under the captions “THE AUTHORITY” and “ABSENCE OF MATERIAL LITIGATION — The Authority,” as such information applies to the Authority.

**IN CONNECTION WITH THE OFFERING OF THE BONDS, THE UNDERWRITER MAY OVER ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE BONDS OFFERED HEREBY AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.**

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#### **CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING STATEMENTS IN THIS LIMITED OFFERING MEMORANDUM**

Certain statements included or incorporated by reference in this Limited Offering Memorandum constitute “forward-looking statements.” Such statements generally are identifiable by the terminology used such as “plan,” “expect,” “estimate,” “budget” or other similar words. Such forward-looking statements include but are not limited to certain statements contained in the information under the captions “RISK FACTORS,” and APPENDIX A – “CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION” in this Limited Offering Memorandum. The achievement of certain results or other expectations contained in such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The Borrower does not plan to issue any updates or revisions to those forward-looking statements if or when changes occur in their expectations or events, conditions or circumstances on which such statements are based.

## TABLE OF CONTENTS

|  | <u>Page</u> |
|--|-------------|
| INTRODUCTION .....   | 1           |
| General .....  | 1           |
| The Bonds .....  | 1           |
| Security for the Bonds .....   | 1           |
| Reserve Account .....  | 2           |
| Repair and Replacement Fund .....  | 2           |
| The Sole Member and the Borrower .....   | 2           |
| The School .....   | 2           |
| Magnolia Educational & Research Foundation .....   | 3           |
| The Authorizer .....   | 3           |
| THE AUTHORITY .....  | 3           |
| THE PROJECT .....  | 4           |
| THE FACILITY .....   | 4           |
| Appraisal and Environmental Report .....   | 4           |
| THE BONDS .....  | 4           |
| General .....  | 5           |
| Book-Entry Only System .....   | 5           |
| Transfer Restrictions .....  | 6           |
| Transfer and Exchange of Bonds .....   | 6           |
| Redemption .....   | 6           |
| Additional Indebtedness; Additional Bonds and Refunding Bonds; Subordinate<br>Indebtedness ..... | 11          |
| Defeasance .....   | 12          |
| ESTIMATED SOURCES AND USES OF FUNDS .....  | 14          |
| DEBT SERVICE SCHEDULE .....  | 15          |
| SECURITY AND SOURCES OF PAYMENT FOR THE BONDS .....  | 15          |
| Limited Obligations of the Authority .....   | 15          |
| Payments Under the Indenture, Loan Agreement and State Intercept .....                           | 16          |
| Allocation of Payments .....   | 17          |
| Application of Reserve Account .....   | 18          |
| Deed of Trust on the Facility .....  | 19          |
| The Lease .....  | 20          |
| CHARTER SCHOOLS IN CALIFORNIA .....  | 23          |
| General .....  | 23          |
| Chartering Authority .....   | 25          |
| Elements of a Charter Petition .....   | 25          |
| Charter Management Organizations .....   | 26          |
| Charter Revocation .....   | 26          |
| Amendments to the Charter School Law .....   | 27          |
| Growth in Charter Schools in California .....  | 27          |
| STATE FUNDING OF EDUCATION .....   | 28          |
| General .....  | 28          |
| Allocation of State Funding to Charter Schools .....   | 37          |
| CONSTITUTIONAL AND STATUTORY PROVISIONS AFFECTING EDUCATION                                      |             |
| REVENUES AND APPROPRIATIONS .....  | 40          |
| Limitations on Revenues .....  | 40          |
| RISK FACTORS .....   | 41          |

|   |  |
|---|--|
| General.....  | 42   |
| School's Reliance on MERF; MERF not Liable on Loan Agreement or Bonds. ....       | 43   |
| California Budget Deficit.....  | 43   |
| Tax Related Issues .....  | 43   |
| Factors That Could Affect the Security Interest in the Pledged Revenues .....     | 44   |
| Limitations On Value of the Facility and to Remedies Under the Deed of Trust..... | 45   |
| Bankruptcy.....   | 46   |
| Key Management.....   | 47   |
| Factors Associated with MERF and the School's Operations .....                    | 47   |
| Inter-Company Transfers .....   | 47   |
| Incurrence of Additional Indebtedness .....                                       | 47   |
| Non-Recourse Debt.....  | 48   |
| Other Limitations on Enforceability of Remedies .....                             | 48   |
| Specific Risks of Charter Schools.....  | 48   |
| Claims and Insurance Coverage.....  | 49   |
| ABSENCE OF MATERIAL LITIGATION.....   | 49   |
| The Authority.....  | 49   |
| The Borrower.....   | 50   |
| MERF.....   | 50   |
| TAX MATTERS.....  | 50   |
| Federally Taxable Bonds .....   | 52   |
| APPROVAL OF LEGALITY.....   | 56   |
| RATING .....  | 57   |
| CONTINUING DISCLOSURE.....  | 57   |
| FINANCIAL ADVISOR .....   | 57   |
| UNDERWRITING .....  | 57   |
| FINANCIAL STATEMENTS.....   | 58   |
| MISCELLANEOUS .....   | 58   |
| APPENDIX A:   | CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION   |
| APPENDIX B:   | AUDITED FINANCIAL STATEMENTS FOR THE SCHOOL AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION FOR FISCAL YEARS ENDED JUNE 30, 2013 AND UNAUDITED FINANCIAL STATEMENTS OF THE SCHOOL AND OF MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION FOR THE PERIOD FROM JULY 1, 2013 THROUGH MARCH 31, 2014 |
| APPENDIX C:   | SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL BOND DOCUMENTS  |
|   | THE INDENTURE  |
|   | THE LOAN AGREEMENT   |
|   | THE DEED OF TRUST  |
|   | THE LEASE  |
| APPENDIX D:   | FORM OF CONTINUING DISCLOSURE AGREEMENT  |
| APPENDIX E:   | BOOK-ENTRY-ONLY SYSTEM   |
| APPENDIX F:   | FORM OF OPINION OF BOND COUNSEL  |
| APPENDIX G:   | FORM OF INVESTOR LETTER  |

## **LIMITED OFFERING MEMORANDUM**

**\$6,020,000**

**CALIFORNIA SCHOOL FINANCE AUTHORITY  
SCHOOL FACILITY REVENUE BONDS  
(MAGNOLIA SCIENCE ACADEMY-1, RESEDA PROJECT)**

**\$5,675,000  
SERIES 2014A**

**\$345,000  
SERIES 2014B (TAXABLE)**

### **INTRODUCTION**

#### **General**

This Limited Offering Memorandum, including the cover page and Appendices hereto (the “Limited Offering Memorandum”), is provided to furnish information with respect to the sale and delivery of \$5,675,000 aggregate principal amount of School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project) Series 2014A (the “2014A Bonds”) and \$345,000 aggregate principal amount of School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project) Series 2014A (the “2014B Bonds” and together with the 2014A Bonds, the “Bonds”) of the California School Finance Authority (the “Authority”). Capitalized terms not otherwise defined herein shall have the meanings set forth in the Indenture or the Lease (each defined below). See APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL BOND DOCUMENTS – THE LEASE” herein.

#### **The Bonds**

The Bonds will be issued pursuant to the Constitution and laws of the State of California and particularly under and pursuant to Articles 1 through 4 (commencing with section 6500) of Chapter 5 of Division 7 of Title 1 of the California Government Code (the “Law”), and an Indenture, dated as of June 1, 2014 (the “Indenture”), by and between the Authority and The Bank of New York Mellon Trust Company, N.A., San Francisco, California, as trustee (the “Trustee”). The Bonds will bear interest on January 1 and July 1 of each year, commencing January 1, 2015 (each an “Interest Payment Date”) and will be subject to optional, mandatory and extraordinary redemption prior to maturity as set forth under “THE BONDS – Redemption” herein. The proceeds of the Bonds will be loaned to MPM Sherman Way LLC, a California limited liability company (the “Borrower”) whose sole member is Magnolia Properties Management, Inc., a California nonprofit public benefit corporation (the “Sole Member”), pursuant to a Loan Agreement, dated as of June 1, 2014 (the “Loan Agreement”), between the Authority and the Borrower. The proceeds of such loan will be used, along with other available funds, to finance the acquisition, improvement and equipping of the land and facilities located at 18238 Sherman Way, Reseda, California 91335 (as more fully described herein, the “Facility”), to be owned by the Borrower and leased to Magnolia Educational & Research Foundation (“MERF”), a California nonprofit public benefit corporation, also known as Magnolia Public Schools, for use and occupancy by Magnolia Science Academy 1, also known as Magnolia Science Academy (the “School”), to fund a deposit to the Repair and Replacement Fund (described herein), and to pay costs of issuance of the Bonds. See APPENDIX A – “CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION” herein.

#### **Security for the Bonds**

The Bonds will be payable out of Payments (as defined below) under the Indenture, consisting primarily of Loan Repayments under the Loan Agreement. The obligations of the Borrower under the Loan Agreement are secured by: (i) the rent payments received under the Lease (as defined below) (ii)

real property described in the Deed of Trust (as defined below) on the Facility and (iii) if necessary, the Reserve Account. The Reserve Account is expected to be funded initially by proceeds of a Charter School Facilities Credit Enhancement Grant awarded to the Borrower by the Authority. See “SECURITY AND SOURCES OF PAYMENT FOR THE BONDS” herein.

### **Reserve Account**

On the date of issuance of the Series 2014 Bonds, \$446,562.50, constituting the Reserve Account Requirement for the 2014 Bonds, will be deposited in the Grant-Funded Reserve Subaccount of the Reserve Account created under the Indenture. The Reserve Account is expected to be funded initially by proceeds of a Charter School Facilities Credit Enhancement Grant awarded to the Borrower by the Authority. Amounts in the Reserve Account will be used and withdrawn by the Trustee solely for the purpose of making up any deficiency in the Interest Account or Principal Account that exists on the date when monies on deposit in the Interest Account or the Principal Account are required to be applied, as provided in the Indenture, or (together with any other moneys available therefor) for the payment or redemption of all Bonds then Outstanding; provided, however, that monies and securities held by the Trustee in the Grant-Funded Reserve Subaccount will not be used for the redemption of all Bonds then Outstanding, pursuant to the Indenture. See “SECURITY AND SOURCES OF PAYMENT FOR THE BONDS” herein.

### **Repair and Replacement Fund**

On the date of issuance of the Bonds, proceeds in the amount of \$100,000 (constituting the Repair and Replacement Fund Requirement as of such date) will be deposited in the Repair and Replacement Fund. The Borrower is required to make payments under the Loan Agreement to fund any shortfalls in the Repair and Replacement Fund Requirement. Amounts in the Repair and Replacement Fund may be requisitioned by the Borrower to fund capital items not budgeted as ordinary maintenance and repair costs related to the Facility. See “SECURITY AND SOURCES OF PAYMENT FOR THE BONDS” herein.

### **The Sole Member and the Borrower**

The Sole Member is a California nonprofit public benefit corporation formed to support MERF. The Sole Member has received a determination letter from the Internal Revenue Service recognizing it as an organization described in Section 501(c)(3) of the Code.

The Borrower is a single purpose entity with no assets other than the Facility and its rights under the Lease, which have been assigned to the Trustee. The Borrower was formed on October 31, 2013 for the purpose of owning the Facility and is not expected to have any other assets or revenue available to it to make payments due under the Loan Agreement. Therefore, no financial information with respect to the Borrower has been provided in this Limited Offering Memorandum. See APPENDIX A – “CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION.”

### **The School**

The School was established by MERF in the fall of 2002 as its first charter school, serving grades 6-12. Since opening, the School has been in continuous operation at its current location. The charter for the School was originally approved by the Los Angeles Unified School District in 2002, and has been renewed twice, in 2007 and 2012. The current charter expires June 30, 2017. See APPENDIX A – “CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION.”



## **Magnolia Educational & Research Foundation**

MERF is a California nonprofit public benefit corporation formed in August 1997, and headquartered in Los Angeles, California. MERF has received a determination letter from the Internal Revenue Service recognizing it as an organization described in Section 501(c)(3) of the Code. MERF operates the School and designates the members of the board of directors of the Sole Member, which is the sole member of the Borrower. MERF will lease the Facility as lessee under the Lease (as defined below), for use and occupancy by the School; however, neither MERF nor the Sole Member is a party to the Loan Agreement, and neither MERF nor the Sole Member has any liability thereunder in respect to repayment of the Loan and the Bonds.

The vision of MERF is to inspire students to choose career paths in science and technology. In the fall of 2002, MERF established the School as its first charter school. Since then, MERF has established another ten charter schools with the goal of providing innovative and high-quality education to the nearby community in Southern California. In 2009, MERF was approved by the California State Board of Education to start ten state-wide benefit charter school sites in California over the following six years, only the third time that a charter school operator has been granted such permission in California. The first two school sites operating under the statewide benefit charter opened in Sacramento and Orange County in August 2009. MERF expects to establish additional charter schools throughout California.

For additional information on MERF and the School, see APPENDIX A – “CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION” herein.

## **The Authorizer**

The Los Angeles Unified School District (“LAUSD”) was established in 1853 and serves as the School’s authorizer. The LAUSD is currently the second largest school district in the nation, with more than 640,000 students enrolled in kindergarten through 12th grade, and over 1,000 schools, including public charter schools. The boundaries of the LAUSD cover 720 square miles including the City of Los Angeles as well as all or parts of 31 smaller municipalities and several unincorporated areas. As of 2012-13, the Los Angeles Unified School District had authorized 241 charter schools. See “CHARTER SCHOOLS IN CALIFORNIA.”

## **THE AUTHORITY**

The Authority is a public instrumentality of the State of California created pursuant to provisions of the Act. The Authority is authorized to issue the Bonds under the Act and to make the loan contemplated by the Loan Agreement and to secure the Bonds by a pledge of payments received by the Authority pursuant to the Loan Agreement and certain other sources of payments as provided in the Indenture.

The Authority has entered into, sold and delivered obligations, and will in the future enter into, sell and deliver obligations, other than the Bonds, which other obligations are and will be secured by instruments separate and apart from the Indenture and the Loan Agreement. The holders of such obligations of the Authority have no claim on the security for the Bonds, and the owners of the Bonds will have no claim on the security for such other obligations issued by the Authority.

## THE PROJECT

A portion of the proceeds of the Bonds will be used to finance the acquisition and improvement of the Facility, approximately as follows:

|               |                       |
|---------------|-----------------------|
| Acquisition   | \$4,500,000.00        |
| Improvements  | <u>\$1,000,000.00</u> |
| <b>Total:</b> | <b>\$5,500,000.00</b> |

The planned improvements to the Facility include creating a new main office area, creation of additional classroom space, addition of a shade structure, planter boxes and seating in the lunch area, installation of interior and exterior windows, an additional bathroom, stair railings, lighting and flooring, as well as new furnishings, signage and an entry canopy. For additional information about the Project, see APPENDIX A – “CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION” and “ESTIMATED SOURCES AND USES OF FUNDS” below.

## THE FACILITY

The Facility is located at 18238 Sherman Way in Reseda, California, and serves as the existing location for the School. The 26,950 square foot Facility was originally built in 1955 and provides capacity to serve a total of approximately 500 students. The Facility currently includes six administrative offices, twenty classrooms, one computer laboratory and two science laboratories. An additional science laboratory will be added as part of the renovations. See APPENDIX A – “CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION” herein for further information about the Project and the Facility.

### Appraisal and Environmental Report

*The Appraisal.* In connection with issuance of the Series 2014 Bonds, the Borrower obtained an appraisal of the Facility (the “Appraisal”) dated December 12, 2012, prepared by Babcock & Macksoud, La Cañada Flintridge, California (the “Appraiser”). The Appraiser estimated the “as is” value of the Facility to be \$4,500,000.

*The Environmental Report.* The Borrower obtained a Phase I Environmental Site Assessment for the Facility, dated November 5, 2013, prepared by Centec Engineering, La Crescenta, California. The assessment did not reveal evidence of any “recognized environmental condition” associated with the current or former use of the property.

Copies of the Appraisal and the Environmental Report may be obtained from the Underwriter during the underwriting period at: RBC Capital Markets, LLC 2398 E. Camelback Road, Suite 700, Phoenix, Arizona 85016.

## THE BONDS

*The following is a summary of certain provisions of the Bonds. Reference is made to the Bonds for the complete text thereof and to the Indenture for all of the provisions relating to the Bonds. The discussion herein is qualified by such reference.*

## **General**

The Bonds are being issued pursuant to the Indenture securing the Bonds in the aggregate principal amount set forth on the cover of this Limited Offering Memorandum. The Bonds will be issued as registered Bonds in denominations of \$100,000 and any integral multiple of \$5,000 in excess thereof. The Bonds will be dated the date of issuance and will bear interest at the rate set forth on the inside cover page hereof from their dated date. Interest on the Bonds will be calculated on the basis of a 360-day year of twelve 30-day months and will be payable in arrears on each Interest Payment Date. The Bonds will mature in the amounts and in each of the years as set forth on the inside cover page hereof.

The Bonds, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC” or the “Depository”), and will be evidenced by one Bond for each maturity in the total aggregate principal amount of the Bonds of such maturity. Registered ownership of the Bonds, or any portion thereof, may not thereafter be transferred except as set forth in the Indenture. So long as Cede & Co. is the registered owner of the Bonds, as nominee of DTC, references herein to the bondholders, holders or registered owners will mean Cede & Co. as aforesaid and will not mean the “Beneficial Owner” of the Bonds.

The principal of and interest on the Bonds will be payable in lawful money of the United States of America upon surrender at the principal corporate trust office of the Trustee. The interest on any Bond will be payable to the person whose name appears on the registration books of the Trustee as the registered owner thereof as of the close of business on the fifteenth day of the calendar month next preceding the Interest Payment Date, whether or not such day is a Business Day (the “Record Date”), such interest to be paid by check mailed by first class mail, postage prepaid, on the Interest Payment Date, to the registered owner at his or her address as it appears on such registration books. Notwithstanding the foregoing, however, any holder of \$1,000,000 or more in an aggregate principal amount of the Bonds will be entitled to receive payments of interest on the Bonds held by it by wire transfer of immediately available funds to such bank or trust company located within the United States of America as such holder will designate in writing to the Trustee at least one Business Day before the first Record Date for such payment. So long as Cede & Co. is the registered owner of the Bonds, principal of and interest on the Bonds are payable in same day funds by the Trustee to Cede & Co., as nominee for the Depository.

Any interest not punctually paid or duly provided for will thereafter cease to be payable to the bondholder on such Record Date and will be paid to the person in whose name the Bond is registered at the close of business on the date established by the Trustee pursuant to the Indenture as a record date for the payment of defaulted interest on the Bonds (the “Special Record Date”). The Special Record Date will be fixed by the Trustee, notice thereof being given to the Bondholders not less than 10 days prior to such Special Record Date.

## **Book-Entry Only System**

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered certificate will be issued for the Bonds set forth on the inside cover of this Limited Offering Memorandum, and will be deposited with DTC. For additional information regarding DTC and its book-entry only system, see APPENDIX E – “BOOK-ENTRY-ONLY SYSTEM” herein.

## **Transfer Restrictions**

The Bonds may not be registered in the name of, or transferred to, and the Beneficial Owner cannot be, any person except an Approved Institutional Buyer. Bonds registered in the name of the Depository or its nominee shall be deemed to comply with the foregoing requirement so long as each beneficial owner of the Bonds is an Approved Institutional Buyer. Each initial Beneficial Owner shall provide to the Authority and the Trustee an executed Investor Letter in substantially the form set forth as APPENDIX G.

The foregoing limitation shall cease to apply (without notice to or consent of any Bondholder) if, upon and after receipt by the Trustee from the Borrower of a rating letter by Fitch, S&P or Moody's indicating that the Bonds are rated "A-" or "A3," as applicable, or better. Within 10 calendar days after receipt of such notice by the Trustee, the Trustee shall notify each Bondholder that the restrictions on transfer set forth above requiring that the Beneficial Owners of the Bonds be Approved Institutional Buyers shall be of no further force or effect.

## **Transfer and Exchange of Bonds**

Subject to the requirements described under "Transfer Restrictions" above, the registration of any Bond may, in accordance with its terms, be transferred, upon the books required to be kept pursuant to the provisions of the Indenture, by the person in whose name it is registered, in person or by his or her duly authorized attorney, upon surrender of such Bond for cancellation, accompanied by delivery of a written instrument of transfer in a form acceptable to the Trustee, duly executed. The Trustee will require the payment by the Holder requesting such transfer of any tax or other governmental charge required to be paid with respect to such transfer, and there will be no other charge to any Holder for any such transfer.

Bonds may be exchanged at the Principal Corporate Trust Office of the Trustee for a like aggregate principal amount of the Bonds of the same maturity of other authorized denominations. The Trustee will require the payment by the Holder requesting such exchange of any tax or other governmental charge required to be paid with respect to such exchange, and there will be no other charge to any Holder for any such exchange. No exchange of Bonds will be required to be made during the period established by the Trustee for selection of Bonds for redemption and after a Bond has been selected for redemption.

The Trustee will not be required to register the transfer of any Bond which has been selected for redemption in whole or in part, from and after the day of mailing of a notice of redemption of such Bond selected for redemption in whole or in part.

## **Redemption**

*Extraordinary Optional Redemption from Insurance and Condemnation Proceeds.* The Bonds are subject to redemption prior to their stated maturity, at the option of the Borrower, as a whole or in part on any date from moneys required to be transferred from the Insurance and Condemnation Proceeds Fund to the Special Redemption Account at a redemption price equal to the principal amount thereof together with interest accrued thereon to the date fixed for redemption, without premium.

*Extraordinary Optional Construction Related Redemption.* The Bonds are subject to redemption in part prior to their stated maturity, at the option of the Borrower, from excess funds on deposit in the Project Fund following Completion of the Project.

*Extraordinary Mandatory Redemption due to Change of Use.* The Bonds are subject to redemption prior to their stated maturity, as a whole on any date from Loan prepayments made by the Borrower in connection with the cessation of operation of a charter school at the Facility, at a redemption price equal to the principal amount thereof together with interest accrued thereon to the date fixed for redemption, without premium.

*Optional Redemption.* The 2014A Bonds maturing on or after July 1, 2025 are also subject to redemption prior to their respective stated maturities, at the option of the Borrower from any amounts in the Redemption Fund, in whole or in part on any date on or after July 1, 2024, at a redemption price equal to 100% of the principal amount of Bonds called for redemption, plus accrued interest to the date fixed for redemption, without premium.

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*Mandatory Sinking Account Redemption.* The Bonds are also subject to redemption prior to their respective stated maturities in part, by lot, from Mandatory Sinking Account Payments pursuant to the Indenture in the following amounts and on the following dates:

**Series A Term Bonds Maturing July 1, 2024**

| Mandatory Sinking<br>Account Payment Date<br>(July 1) | Principal<br>Amount |
|---|---------------------|
| 2019  | \$80,000            |
| 2020  | 105,000             |
| 2021  | 110,000             |
| 2022  | 115,000             |
| 2023  | 120,000             |
| 2024 <sup>†</sup>                                     | 130,000             |

<sup>†</sup>Maturity.

**Series A Term Bonds Maturing July 1, 2034**

| Mandatory Sinking<br>Account Payment Date<br>(July 1) | Principal<br>Amount |
|---|---------------------|
| 2025  | \$135,000           |
| 2026  | 145,000             |
| 2027  | 150,000             |
| 2028  | 160,000             |
| 2029  | 170,000             |
| 2030  | 180,000             |
| 2031  | 190,000             |
| 2032  | 205,000             |
| 2033  | 215,000             |
| 2034 <sup>†</sup>                                     | 230,000             |

<sup>†</sup>Maturity.

**Series A Term Bonds Maturing July 1, 2044**

| Mandatory Sinking<br>Account Payment Date<br>(July 1) | Principal<br>Amount |
|---|---------------------|
| 2035  | \$240,000           |
| 2036  | 255,000             |
| 2037  | 275,000             |
| 2038  | 290,000             |
| 2039  | 310,000             |
| 2040  | 330,000             |
| 2041  | 350,000             |
| 2042  | 370,000             |
| 2043  | 395,000             |
| 2044 <sup>†</sup>                                     | 420,000             |

<sup>†</sup>Maturity.

### Series B Term Bonds Maturing July 1, 2019

| Mandatory Sinking<br>Account Payment Date<br>(July 1) | Principal<br>Amount |
|---|---------------------|
| 2015  | \$70,000            |
| 2016  | 80,000              |
| 2017  | 85,000              |
| 2018  | 90,000              |
| 2019 <sup>†</sup>                                     | 20,000              |

<sup>†</sup>Maturity.

*Notice of Redemption.* In connection with the redemption of the Bonds pursuant to the Indenture (other than mandatory sinking account redemption), the Borrower shall give notice of redemption to the Trustee (with a copy to the Authority) not less than thirty (30) days prior to the redemption date. Notice of redemption of any Bonds shall be given by the Trustee upon the written request of the Borrower. Notice of redemption of any Bonds shall be mailed postage prepaid, not less than twenty (20) nor more than sixty (60) days prior to the redemption date (i) by first class mail to the respective Holders thereof at the addresses appearing on the bond registration books described in the Indenture, and (ii) as may be further required in accordance with the Continuing Disclosure Agreement (a copy of the form of which is attached hereto as APPENDIX D). Each notice of redemption shall contain all of the following information: (a) the date of such notice; (b) the name of the Bonds and the date of issue of the Bonds; (c) the redemption date; (d) the redemption price; (e) the dates of maturity of the Bonds to be redeemed; (f) if less than all of the Bonds of any maturity are to be redeemed, the distinctive numbers of the Bonds of each maturity to be redeemed; (g) in the case of Bonds redeemed in part only, the respective portions of the principal amount of the Bonds of each maturity to be redeemed; (h) the CUSIP number, if any, of each maturity of Bonds to be redeemed; (i) a statement that such Bonds must be surrendered by the Holders at the Principal Corporate Trust Office of the Trustee, or at such other place or places designated by the Trustee; (j) a statement that such redemption is conditioned upon the receipt by the Trustee, on or prior to the redemption date, of moneys sufficient to pay the redemption price or upon the happening of such other event as shall be specified therein, and if such moneys shall not have been so received, said notice shall be rescinded and the redemption shall be cancelled; (k) a statement that any such redemption notice can be rescinded as provided in the Indenture; and (l) notice that further interest on such Bonds, if any, will not accrue from and after the designated redemption date.

Such redemption notices may state that no representation is made as to the accuracy or correctness of the CUSIP numbers provided therein or on the Bonds. If money is not received as described in subsection (j) above, the Trustee, within a reasonable time after the date on which such redemption was to occur, give notice to the persons and in the manner in which the notice of redemption was given, that such moneys were not so received and that there will be no redemption of the Bonds pursuant to the notice of redemption. Failure of the Trustee to give such notice or any defect therein shall not in any way impair or affect the validity of the proceedings for redemption.

*Conditional Notice.* Any notice of optional redemption may state that such redemption shall be conditioned ("Conditional Notice") upon the receipt by the Trustee on or prior to the date fixed for such redemption of moneys sufficient to pay the principal of, premium, if any, and interest on such Bonds to be redeemed or upon the occurrence of such other event or condition as shall be set forth in such Conditional Notice, and that, if such moneys shall not have been so received, or if such other event or condition shall have occurred or failed to occur (as the case may be), such Conditional Notice shall be of no force and

effect and the redemption of the Bonds specified in the Conditional Notice shall no longer be required. The Trustee shall within a reasonable time thereafter give notice, in the manner in which the original Conditional Notice was given, of the cancellation of such redemption.

*Effect of Notice.* A certificate of the Trustee or the Borrower that notice of call and redemption has been given to Holders and as may be further required in the Continuing Disclosure Agreement as provided in the Indenture will be conclusive as against all parties. The actual receipt by the Holder of any Bond or any other party of notice of redemption will not be a condition precedent to redemption, and failure to receive such notice, or any defect in the notice given, will not affect the validity of the proceedings for the redemption of such Bonds or the cessation of interest, if any, on the date fixed for redemption.

Notice of redemption having been given, and the redemption price of the Bonds called for redemption being on deposit or otherwise available to the Trustee, the Bonds designated for redemption will become due and payable on the specified redemption date and interest, if any, will cease to accrue thereon as of the redemption date, and upon presentation and surrender of such Bonds at the place specified in the notice of redemption, such Bonds will be redeemed and paid at the redemption price thereof out of the money provided therefor. The Holders of such Bonds so called for redemption after such redemption date will look for the payment of such Bonds and the redemption premium thereon, if any, only to the escrow fund established for such purpose. All Bonds redeemed will be cancelled by the Trustee and will not be reissued.

*Right to Rescind Notice.* Upon oral notice promptly confirmed by written notice from the Borrower that the Borrower has cured the conditions that caused the Bonds to be subject to extraordinary redemption, the Borrower may rescind any extraordinary redemption and notice thereof on any date prior to the date fixed for redemption by causing written notice of the rescission to be given to the Holders of the Bonds so called for redemption, with a copy to the Trustee. Notice of rescission of redemption will be given in the same manner in which notice of redemption was originally given. The actual receipt by the Holder of any Bond of notice of such rescission will not be a condition precedent to rescission, and failure to receive such notice or any defect in such notice will not affect the validity of the rescission.

*Funds for Redemption.* Prior to or on the redemption date of any Bonds there will be available in the Redemption Fund, or held in trust for such purpose as provided by law, monies for the purpose and sufficient to redeem, at the premiums payable as in the Indenture provided, the Bonds designated in said notice of redemption. Such monies so set aside in the Redemption Fund or in the escrow fund established for such purpose will be applied on or after the redemption date solely for payment of principal of and premium, if any, on the Bonds to be redeemed upon presentation and surrender of such Bonds, provided that all monies in the Redemption Fund shall be used for the purposes established and permitted by law. Any interest due on or prior to the redemption date will be paid from the Redemption Fund, unless otherwise provided for to be paid from an escrow fund established for such purpose. If, after all of the Bonds have been redeemed and cancelled or paid and cancelled, there are monies remaining in the Redemption Fund or otherwise held in trust for the payment of redemption price of the Bonds, said monies will be held in or returned or transferred to the Redemption Fund for payment of any outstanding Bonds of the Borrower payable from said fund; provided, however, that if said monies are part of the proceeds of refunding Bonds of the Borrower, said monies will be transferred to the fund created for the payment of principal of and interest on such Bonds. If no such refunding Bonds of the Borrower are at such time outstanding, said monies will be transferred to the general fund of the Borrower as provided and permitted by law.

*Selection of Bonds for Redemption.* When any redemption is made pursuant to any of the provisions of the Indenture and less than all of the Outstanding Bonds are to be redeemed, the Trustee



will select the Bonds to be redeemed from the Outstanding Bonds not previously called for redemption, by lot within a maturity and, if from more than one maturity, in inverse order of maturity or in such other order of maturity as shall be specified in a Request of the Borrower and the Mandatory Sinking Account Payments will be reduced pro-rata. In no event will Bonds be redeemed in amounts other than whole multiples of Authorized Denominations. For purposes of redeeming Bonds in denominations greater than minimum Authorized Denominations, the Trustee will assign to such Bonds a distinctive number for each such principal amount and, in selecting Bonds for redemption by lot, will treat such amounts as separate Bonds.

### **Additional Indebtedness; Additional Bonds and Refunding Bonds; Subordinate Indebtedness**

In the Loan Agreement, the Borrower agrees not to incur, or to cause the School to incur, any additional indebtedness secured in whole or in part by Liens on the Facility and the Gross Revenues of the School, that are senior to the Deed of Trust and the security interest in the Gross Revenues. The Borrower further agrees not to incur, or to cause the School to incur, any additional indebtedness secured on a parity with the Bonds and in whole or in part by Liens on the Facility or the Gross Revenues (with the exception of the securing of alternate financing that contemporaneously pays in full all obligations of the Borrower under the Loan Agreement and of the School under the Lease); provided that the Borrower may incur additional parity indebtedness in connection with the issuance of Additional Bonds or Refunding Bonds pursuant to the Indenture, if the Borrower has delivered evidence to the Trustee that the Debt Service Coverage Ratio in respect of the School, as calculated pursuant to the Lease, for the preceding Fiscal Year was equal to or greater than 1.2 to 1 and that the projected Debt Service Coverage Ratio for the Fiscal Year in which such additional parity indebtedness will be incurred and for one subsequent Fiscal Year, taking into account the additional indebtedness, will be equal to or greater than 1.2 to 1. The Borrower also acknowledges and agrees in the Loan Agreement that it is subject to and shall be required to satisfy any additional requirements of the Indenture relative to the issuance of Additional Bonds or Refunding Bonds.

*Additional Bonds.* In accordance with the Indenture and the Loan Agreement, one or more Series of Additional Bonds may be issued, authenticated and delivered for the purpose of financing or refinancing the construction, installation and equipping of additions, renovations, betterments, extensions or improvements to the Project and the Facility. Additional Bonds issued for such purposes shall be issued in a principal amount not to exceed, together with other moneys available therefor, the Borrower's estimate (based such information to be provided by the Borrower to the Authority) of the reasonable costs of the project to be financed or refinanced with the proceeds of the sale of such Additional Bonds, including providing amounts for the costs incidental to or connected with any such financing and the making of any deposits into the Reserve Account and any of the funds and accounts required by the provisions of the Supplemental Indenture authorizing such Series of Additional Bonds. Additional Bonds of each Series will be authenticated and delivered by the Trustee only upon receipt by the Trustee of a Certificate of an Authorized Representative of the Borrower to the effect that the requirements of the Loan Agreement are satisfied in connection with the issuance of such Additional Bonds.

*Refunding Bonds.* One or more Series of Refunding Bonds may be issued, authenticated and delivered to refund all or any portion of the Outstanding Bonds of one or more Series including any portion of any maturity within one or more Series. Refunding Bonds shall be issued in a principal amount sufficient, together with other moneys available therefor, to accomplish such refunding, including providing amounts for the costs incidental to or connected with any such financing and the making of any deposits into the Reserve Account and any of the funds and accounts required by the provisions of the Supplemental Indenture authorizing such Series of Refunding Bonds. Refunding Bonds of each Series shall be authenticated and delivered by the Trustee only upon: (1) Satisfaction of the provisions of the Indenture with respect to the refunded Bonds; (2) Receipt by the Trustee of any documents required under

the Indenture and under the Loan Agreement; and (3) Receipt by the Trustee of a Certificate of an Authorized Representative of the Borrower to the effect that the requirements of the Loan Agreement are satisfied in connection with the issuance of such Refunding Bonds.

*Subordinate Indebtedness of the Borrower.* Under the Loan Agreement, the Borrower may incur subordinate Indebtedness and may create Liens on the Facility and the Gross Revenues, or other assets of the Borrower securing such subordinate Indebtedness, so long as such Indebtedness is (i) subordinate to the Deed of Trust and obligations under the Loan Agreement and (ii) incurred by the Borrower in the ordinary course of business and does not exceed \$1,000,000.

See APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL BOND DOCUMENTS – THE LOAN AGREEMENT - Additional Covenants and Agreements of Borrower – Limited Purpose of the Borrower; Limitations on Additional Debt; Permitted Liens.”

### **Defeasance**

*Discharge of Indenture.* Bonds may be paid or caused to be paid by the Authority in any of the following ways, provided any other sums payable under the Indenture by the Authority have also been paid or caused to be paid: (i) by paying or causing to be paid the principal of and interest on the Bonds Outstanding as and when the same become due and payable; (ii) by depositing with the Trustee, in trust, at or before maturity, money or securities in the necessary amount to pay or redeem Bonds Outstanding; or (iii) by delivering to the Trustee, for cancellation by it, all Bonds Outstanding.

If all Bonds then Outstanding are paid or caused to be paid as provided above and all other sums payable under the Indenture by the Authority, then and in that case, at the election of the Borrower, and notwithstanding that any Bonds will not have been surrendered for payment, the Indenture and the pledge of Payments made under the Indenture and all covenants, agreements and other obligations of the Authority under the Indenture will cease, terminate, become void and be completely discharged and satisfied, except as provided in the Indenture. In such event, upon request of the Borrower, the Trustee will cause an accounting for such period or periods as may be requested by the Borrower to be prepared and filed with the Borrower and will execute and deliver to the Borrower all such instruments as may be necessary or desirable to evidence such discharge and satisfaction, and the Trustee will pay over, transfer, assign or deliver to the Borrower all moneys or securities or other property held by it pursuant to the Indenture which are not required for the payment of Bonds not theretofore surrendered for such payment and which are not required for the payment of fees and expenses of the Trustee.

Under no circumstances will any amounts on deposit in the Grant Reserve Subaccount be applied to pay or cause to be paid principal of or interest on the Bonds pursuant to the Indenture.

*Discharge of Liability on Bonds.* Upon the deposit with the Trustee, in trust, at or before maturity, of money or securities in the necessary amount to pay any Outstanding Bond, whether upon or prior to its maturity, then all liability of the Authority in respect of such Bond will cease, terminate and be completely discharged, except only that thereafter the holder thereof will be entitled to payment of the principal of and interest on such Bond by the Authority, and the Authority will remain liable for such payment but only out of the money or securities deposited with the Trustee as aforesaid for its payment; provided further, however, that the provisions of the Indenture as described under “–Payments of Bonds after Discharge of Indenture” below will apply in all events.

The Bonds may at any time be surrendered to the Trustee for cancellation by the Authority or the Borrower, which may have been acquired in any manner whatsoever, and such Bonds, upon such surrender and cancellation, will be deemed to be paid and retired.

*Deposit of Money or Securities with Trustee.* Whenever in the Indenture it is provided or permitted that there be deposited with or held in trust by the Trustee money or securities in the amount necessary to pay any Bonds, such amount (which may include money or securities held by the Trustee in the funds established pursuant to the Indenture) will be equal (taking into account income which will accrue from the investment thereof on the date of deposit of such funds but without taking into account any income from the subsequent reinvestment thereof) to the principal amount of such Bonds and all unpaid interest thereon to maturity, and will be: (a) lawful money of the United States of America; or (b) noncallable bonds, bills and bonds issued by the Department of the Treasury (including without limitation (1) obligations issued or held in book-entry form on the books of the Department of the Treasury and (2) the interest component of Resolution Funding Corporation strips for which separation of principal and interest is made by request to the Federal Reserve Bank of New York in book-entry form), United States Treasury Obligations State and Local Government Series and Zero Coupon United States Treasury Bonds; provided, in each case, that the Trustee will have been irrevocably instructed (by the terms of the Indenture or by request of the Authority or the Borrower) to apply such money to the payment of such principal of and interest on such Bonds and provided, further, that the Trustee will have received (i) an Opinion of Bond Counsel to the effect that such deposit will not cause interest on the Bonds to be included in the gross income of the holder thereof for federal income tax purposes and that the Bonds to be discharged are no longer Outstanding; and (ii) a verification report of a firm of certified public accountants or other financial services firm acceptable to the Trustee verifying that the money or securities so deposited or held together with earnings thereon will be sufficient to make all payments of principal of and interest on the Bonds to be discharged to and including their maturity date.

*Payment of Bonds after Discharge of Indenture.* Notwithstanding any provision of the Indenture, and subject to applicable escheat laws, any moneys held by the Trustee in trust for the payment of the principal of or interest on any Bonds and remaining unclaimed for one year after the principal of all the Outstanding Bonds has become due and payable (whether at maturity or by declaration as provided in the Indenture), if such moneys were so held at such date, or two years after the date of deposit of such moneys if deposited after said date when all of the Bonds became due and payable, will be repaid to the Borrower free from the trusts created by the Indenture, and all liability of the Trustee with respect to such moneys will thereupon cease; provided, however, that before the repayment of such moneys to the Borrower as aforesaid, the Trustee may (at the cost of the Borrower) first mail to the holders of Bonds which have not yet been paid, at the addresses shown on the registration books maintained by the Trustee, a notice, in such form as may be deemed appropriate by the Trustee, with respect to the Bonds so payable and not presented and with respect to the provisions relating to the repayment to the Borrower of the moneys held for the payment thereof.

### ESTIMATED SOURCES AND USES OF FUNDS

| <b>Sources of Funds</b>               | <b>2014A Bonds</b>           | <b>2014B Bonds</b>         | <b>Total</b>                 |
|---------------------------------------|------------------------------|----------------------------|------------------------------|
| Bond Principal                        | \$5,675,000.00               | \$345,000.00               | \$6,020,000.00               |
| CSFA DSRF Grant                       | <u>446,562.50</u>            | <u>---</u>                 | <u>446,562.50</u>            |
| <b>Total</b>                          | <u><u>\$6,121,562.50</u></u> | <u><u>\$345,000.00</u></u> | <u><u>\$6,466,562.50</u></u> |
| <br>                                  |                              |                            |                              |
| <b>Uses of Funds</b>                  |                              |                            |                              |
| Property Acquisition                  | \$4,467,909.04               | ---                        | \$4,467,909.04               |
| Improvement Costs                     | 993,647.71                   | ---                        | 993,647.71                   |
| Bond Reserve Account                  | 446,562.50                   | ---                        | 446,562.50                   |
| Costs of Issuance Fund <sup>(1)</sup> | 113,443.25                   | \$345,000.00               | 458,443.25                   |
| Repair and Replacement                | <u>100,000.00</u>            | <u>---</u>                 | <u>100,000.00</u>            |
| Fund Deposit                          |                              |                            |                              |
| <b>Total</b>                          | <u>\$6,121,562.50</u>        | <u>\$345,000.00</u>        | <u>\$6,466,562.50</u>        |

<sup>(1)</sup>Includes legal, printing, rating, underwriting discount, other miscellaneous costs of issuance and additional proceeds.

## DEBT SERVICE SCHEDULE

The annual debt service payment requirements of the Bonds are set forth in the table below.

| <b>Fiscal Year<br/>Ending<br/>July 1</b> | <b><u>Principal</u></b> | <b><u>Interest</u></b> | <b><u>Total</u></b>    |
|--|-------------------------|------------------------|------------------------|
| 2015                                     | \$ 70,000               | \$372,895.66           | \$442,895.66           |
| 2016                                     | 80,000                  | 362,887.50             | 442,887.50             |
| 2017                                     | 85,000                  | 357,287.50             | 442,287.50             |
| 2018                                     | 90,000                  | 351,337.50             | 441,337.50             |
| 2019                                     | 100,000                 | 345,037.50             | 445,037.50             |
| 2020                                     | 105,000                 | 339,437.50             | 444,437.50             |
| 2021                                     | 110,000                 | 333,925.00             | 443,925.00             |
| 2022                                     | 115,000                 | 328,150.00             | 443,150.00             |
| 2023                                     | 120,000                 | 322,112.50             | 442,112.50             |
| 2024                                     | 130,000                 | 315,812.50             | 445,812.50             |
| 2025                                     | 135,000                 | 308,987.50             | 443,987.50             |
| 2026                                     | 145,000                 | 300,887.50             | 445,887.50             |
| 2027                                     | 150,000                 | 292,187.50             | 442,187.50             |
| 2028                                     | 160,000                 | 283,187.50             | 443,187.50             |
| 2029                                     | 170,000                 | 273,587.50             | 443,587.50             |
| 2030                                     | 180,000                 | 263,387.50             | 443,387.50             |
| 2031                                     | 190,000                 | 252,587.50             | 442,587.50             |
| 2032                                     | 205,000                 | 241,187.50             | 446,187.50             |
| 2033                                     | 215,000                 | 228,887.50             | 443,887.50             |
| 2034                                     | 230,000                 | 215,987.50             | 445,987.50             |
| 2035                                     | 240,000                 | 202,187.50             | 442,187.50             |
| 2036                                     | 255,000                 | 187,187.50             | 442,187.50             |
| 2037                                     | 275,000                 | 171,250.00             | 446,250.00             |
| 2038                                     | 290,000                 | 154,062.50             | 444,062.50             |
| 2039                                     | 310,000                 | 135,937.50             | 445,937.50             |
| 2040                                     | 330,000                 | 116,562.50             | 446,562.50             |
| 2041                                     | 350,000                 | 95,937.50              | 445,937.50             |
| 2042                                     | 370,000                 | 74,062.50              | 444,062.50             |
| 2043                                     | 395,000                 | 50,937.50              | 445,937.50             |
| 2044                                     | 420,000                 | 26,250.00              | 446,250.00             |
| <b>Total</b>                             | <b>\$6,020,000</b>      | <b>\$7,304,133.16</b>  | <b>\$13,324,133.16</b> |

## SECURITY AND SOURCES OF PAYMENT FOR THE BONDS

### Limited Obligations of the Authority

The Bonds are limited obligations of the Authority. The Authority is not obligated to advance any moneys derived from any source other than Payments (defined below) and other assets pledged under the Indenture, whether for the payment of the principal, redemption price or interest with respect to the Bonds.

THE BONDS DO NOT CONSTITUTE A DEBT OR LIABILITY OF THE STATE OF CALIFORNIA OR OF ANY POLITICAL SUBDIVISION THEREOF, OTHER THAN THE AUTHORITY, AND ARE NOT A PLEDGE OF THE FAITH AND CREDIT OF THE STATE, OR ANY POLITICAL SUBDIVISION THEREOF, BUT SHALL BE PAYABLE SOLELY FROM THE FUNDS PROVIDED THEREFOR. NEITHER THE STATE NOR THE AUTHORITY SHALL BE OBLIGATED TO PAY THE PRINCIPAL OF THE BONDS, OR THE REDEMPTION PREMIUM OR INTEREST THEREON, EXCEPT FROM THE FUNDS PROVIDED THEREFOR UNDER THE INDENTURE. THE ISSUANCE OF THE BONDS SHALL NOT DIRECTLY, INDIRECTLY OR CONTINGENTLY OBLIGATE THE STATE OF CALIFORNIA OR ANY POLITICAL SUBDIVISION THEREOF TO LEVY OR TO PLEDGE ANY FORM OF TAXATION OR TO MAKE ANY APPROPRIATION FOR THEIR PAYMENT. THE AUTHORITY HAS NO TAXING POWER. NOTHING IN THE INDENTURE, THE ACT OR OTHERWISE IS AN UNDERTAKING BY THE AUTHORITY OR THE STATE OR ANY POLITICAL SUBDIVISION THEREOF TO FUND THE TRANSFERS DESCRIBED IN THE INTERCEPT NOTICE (DEFINED HEREIN) OR TO MAKE STATE APPORTIONMENTS OR OTHER FUNDS AVAILABLE TO THE SCHOOL IN ANY AMOUNT OR AT ANY TIME.

### **Payments Under the Indenture, Loan Agreement and State Intercept**

The Authority has executed and delivered the Indenture and absolutely assigns to the Trustee all of its rights, title and interest in and to the Payments (as defined below), the Loan Agreement, the Deed of Trust, the Lease and all moneys and investments in the funds established thereunder (except the Rebate Fund and Repair and Replacement Fund, as established by the Indenture) for the equal and proportionate benefit, security and protection of all present and future registered owners of the Bonds. The Bonds are payable equally and ratably solely from the Payments under the Indenture. "Payments" under the Indenture means (i) all moneys (except any money received to be used for the payment of Administrative Fees and Expenses) received by the Trustee with respect to the Intercept, (ii) all moneys, if any, received by the Trustee directly from, or on behalf of, the Borrower, pursuant to the Loan Agreement (excluding Additional Payments), and (iii) all income derived from the investment of any money in any fund or account established pursuant to the Indenture (except the Grant-Funded Reserve Subaccount of the Reserve Account). See APPENDIX C – "SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL BOND DOCUMENTS – THE INDENTURE" herein.

The Borrower will pay, or cause to be paid, the Loan Repayments from the Gross Revenues of the Borrower, including the Rental Payments, or from any other legally available funds of the Borrower, without any further notice thereof except as may be specifically required by the Loan Agreement. "Rental Payments" under the Indenture means the amounts payable pursuant to the Lease by MERF to the Borrower for the use and occupancy of the Facility, excluding Expenses (as defined in the Lease). "Loan Repayments" under the Indenture means the amounts due and payable from the Borrower to the Authority pursuant to the Loan Agreement. "Gross Revenues," under the Indenture, means for any Fiscal Year, all of the revenues, income, cash receipts and other money received by the Borrower, or received by the Trustee on behalf of the Borrower pursuant to the Indenture, that are legally available for payment of the obligations of the Borrower under the Loan Agreement.

Simultaneously with the issuance of the Bonds, the School will deliver the Intercept Notice (as defined below) to the State Controller, including a schedule of transfers to the Trustee for certain amounts due and payable under the Indenture, including Additional Payments, and identifying the Trustee as the recipient. "Intercept" means the apportionment from the State Controller, pursuant to Section 17199.4(a)(4) of the Education Code and the Intercept Notice, of amounts specified in the Intercept Notice and payable directly to the Trustee. "Intercept Notice" means any notice from the School to the State Controller, pursuant to Section 17199.4(a)(1) and (4) of the Education Code, specifying a transfer

schedule for the payment directly to the Trustee of one or more of the following: (x) principal of the Bonds, (y) interest on the Bonds and (z) other costs necessary or incidental to financing pursuant to the Act relating to the Bonds, including Additional Payments, in substantially the form set forth in the Lease, as the same may be amended, supplemented or restated from time to time. "Additional Payments" include, among other things, to the extent not paid from Loan Repayments, ordinary administrative fees and expenses of the Trustee and the Authority (including fees and expenses of their counsel and consultants) and fees and expenses of the Rating Agency. However, no moneys deposited in the Revenue Fund pursuant to the Intercept will be deposited to the Repair and Replacement Fund or the Rebate Fund.

The School will, not later than the twentieth (20th) calendar day of any month in which payment is scheduled, amend, supplement or restate the Intercept Notice and deliver such to the State Controller from time to time as necessary or appropriate (including without limitation as a result of redemption prior to maturity or cessation of the Subsidy Payments) to indicate transfers to the Trustee to pay a portion of the amounts due under the Loan Agreement and other costs necessary or incidental to the financing pursuant to the Act, as they come due and to cure any delinquency in payment of such amounts. If at any time the Intercept Notice is amended, supplemented or restated for any reason, the School will promptly provide the Authority and the Trustee with a copy of such amended or supplemented Intercept Notice. The Intercept Notice may provide additional amounts payable to the Trustee for purposes set forth in the Indenture; provided the School will not grant preference or any prior right of funding access or security in respect of the State Apportionment to any other payment indicated in the Intercept Notice or any other notice delivered pursuant to section 17199.4 of the Education Code.

There is no assurance given to Bondholders that the apportionment under the Intercept will be provided in amounts sufficient and at such times as would provide for the Loan Repayments. The State is undertaking no obligation to provide any level of such apportionment in respect of the School. The State may delay, alter, amend or eliminate such funding at any time.

Notwithstanding the foregoing, under the Loan Agreement, the Borrower agrees to fix, charge and collect, or cause to be fixed, charged and collected, rental rates, fees and charges for the use of the Facility such that the ratio of Gross Revenues to Loan Repayments at the end of each Fiscal Year is not less than 1.00:1.00.

### **Allocation of Payments**

Promptly upon receipt, the Trustee will deposit the Payments to the Revenue Fund. On or before March 25<sup>th</sup>, June 25<sup>th</sup>, September 25<sup>th</sup> and December 25<sup>th</sup> of each year, the Trustee shall transfer from the Revenue Fund and deposit into the following respective accounts (each of which the Trustee will establish and maintain within the Revenue Fund) and then to the Repair and Replacement Fund, and to the Rebate Fund, the following amounts, in the following order of priority, the requirements of each such account or fund (including the making up of any deficiencies in any such account resulting from lack of Payments sufficient to make any earlier required deposit) at the time of deposit to be satisfied before any transfer is made to any account or fund subsequent in priority; provided, however, no moneys deposited in the Revenue Fund pursuant to the Intercept shall be deposited to the Repair and Replacement Fund or the Rebate Fund:

(1) To the Interest Account, one-half of the aggregate amount of interest becoming due and payable on the next succeeding Interest Payment Date on all Bonds then Outstanding, until the balance in said account is equal to said aggregate amount of interest;

(2) To the Principal Account, one-fourth of the aggregate amount of principal becoming due to redeem or pay, until the balance in said Principal Account is equal to said aggregate amount of such

principal and Mandatory Sinking Account Payments; provided that from the date of delivery of the Bonds until the first Principal Payment Date with respect to the Bonds (if less than twelve months), transfers to the Principal Account shall be sufficient on a monthly pro rata basis to pay the principal becoming due and payable on said Principal Payment Date;

(3) To the Grant-Funded Reserve Subaccount of the Reserve Account, (a) the greater of (i) the amount designated for deposit to the Grant-Funded Reserve Subaccount of the Reserve Account in a written direction of the Borrower, and (ii) one-half of the aggregate amount of each prior withdrawal from the Grant-Funded Reserve Subaccount of the Reserve Account for the purpose of making up a deficiency in the Interest Account or Principal Account (until deposits on account of such withdrawal are sufficient to fully restore the amount withdrawn), and (b) in the event the balance in said subaccount shall be less than the amount deposited in such subaccount due to valuation of the Eligible Securities deposited therein, the amount necessary to increase the balance in said account to an amount at least equal to the amount deposited in such subaccount (until deposits on account of such valuation deficiency are sufficient to increase the balance in said account to said amount);

(4) To the Bond Reserve Subaccount of the Reserve Account, (a) the greater of (i) the amount designated for deposit to the Bond Reserve Subaccount of Reserve Account in a written direction of the Borrower, and (ii) one-fourth of the aggregate amount of each prior withdrawal from the Reserve Account for the purpose of making up a deficiency in the Interest Account or Principal Account (until deposits on account of such withdrawal are sufficient to fully restore the amount withdrawn), provided that no deposit need be made into the Reserve Account if the balance in said account is at least equal to the Reserve Account Requirement, and (b) in the event the balance in said account shall be less than the Reserve Account Requirement due to valuation of the Eligible Securities deposited therein, the amount necessary to increase the balance in said account to an amount at least equal to the Reserve Account Requirement (until deposits on account of such valuation deficiency are sufficient to increase the balance in said account to said amount);

(5) To the Repair and Replacement Fund, (a) the greater of (i) the amount designated for deposit in the Repair and Replacement Fund in a written direction of the Borrower, and (ii) one-sixth of the aggregate amount of each prior withdrawal from the Repair and Replacement Fund, provided that no deposit need be made into the Repair and Replacement Fund if the balance in said account is at least equal to the Repair and Replacement Requirement, and (b) in the event the balance in said account shall be less than the Repair and Replacement Requirement due to valuation of the Eligible Securities deposited therein in accordance with Section 5.10, the amount necessary to increase the balance in said account to an amount at least equal to the Repair and Replacement Requirement (until deposits on account of such valuation deficiency are sufficient to increase the balance in said account to said amount);

(6) To the Rebate Fund, such amounts as are required to be deposited therein by the Indenture (including the Tax Certificate); and

Moneys remaining in the Revenue Fund after the foregoing transfers may be transferred on January 1 and July 1 of each year, commencing July 1, 2015, by the Trustee to the Borrower free and clear of the lien of this Indenture.

### **Application of Reserve Account**

The Reserve Account deposit in the amount of \$446,562.50 (constituting the initial Reserve Account Requirement) will be made using grant funds that are governed by the Charter School Credit Enhancement Program administered by the U.S. Department of Education. The Borrower shall repay all grant funds deposited into the Reserve Account under the Charter School Credit Enhancement Program



immediately following the earlier to occur of the final maturity, earlier redemption in full of the Bonds or the date on which no Bonds are Outstanding under the Indenture.

The Trustee will establish and maintain the Reserve Account. Within the Reserve Account, the Trustee will establish and maintain the Bond Reserve Subaccount and the Grant-Funded Reserve Subaccount. All amounts in the Reserve Account will be used and withdrawn by the Trustee solely for the purpose of making up any deficiency in the Interest Account or Principal Account that exists on the date when monies on deposit in the Interest Account or the Principal Account are required to be applied, as provided in the Indenture, or (together with any other moneys available therefor) for the payment or redemption of all Bonds then Outstanding; provided, however, that monies and securities held by the Trustee in the Grant-Funded Reserve Subaccount will not be used for the redemption of all Bonds then Outstanding, pursuant to the Indenture. In the event of any funds on deposit and available in the Bond Reserve Subaccount, the Trustee will draw from the Bond Reserve Subaccount until exhausted prior to drawing from the Grant-Funded Reserve Subaccount.

The Trustee will notify the Authority and the Borrower immediately of any withdrawal from the Reserve Account for the purpose of making up a deficiency in the Interest Account or Principal Account, which notice will specify the amount of such withdrawal from each of the Bond Reserve Subaccount and the Grant-Funded Reserve Subaccount, if any. The Trustee will notify the Authority immediately of the final maturity, earlier redemption in full of the Bonds or the date on which no Bonds are Outstanding under the Indenture.

Immediately following the earlier to occur of the final maturity, earlier redemption in full of the Bonds or the date on which no Bonds are Outstanding under the Indenture, the Trustee will transfer to the Authority any amounts remaining on deposit in the Grant-Funded Reserve Subaccount. Thereafter the Trustee will close the Grant-Funded Reserve Subaccount.

Amounts on deposit in the Reserve Account will be valued by the Trustee at their fair market value each January 1, April 1, July 1 and October 1, and the Trustee will notify the Borrower of the results of such valuation. If the amount on deposit in the Reserve Account on the first (1st) Business Day following such valuation is less than one hundred percent (100%) of the Reserve Account Requirement, the Borrower has agreed in the Loan Agreement to make the deposits to the Reserve Account required by the Indenture. If the amount on deposit in the Reserve Account on the first (1st) Business Day following such valuation is greater than the initial deposit to the Reserve Account, then (i) the amount of money on deposit in the Grant-Funded Reserve Subaccount greater than the Reserve Account Requirement will be paid to the Authority free and clear of the lien of the Indenture and (ii) any additional excess will be withdrawn from the Bond Reserve Subaccount of the Reserve Account and transferred to the Revenue Fund.

### **Deed of Trust on the Facility**

To secure the payment of the Loan, the Borrower will enter into a Deed of Trust and Assignment of Rents for the Facility owned by it, which will also secure payment and performance of the Borrower's obligations with respect to the Loan Agreement. The Borrower will obtain, at its own cost and expense, an ALTA policy or policies of title insurance regarding the Facility, or an endorsement to such policy at the time of and dated as of the date of issuance of the Bonds in an aggregate amount not less than the aggregate principal amount of the Bonds to be Outstanding after the issuance of the Bonds, payable to the Trustee, insuring the title of the Borrower to the Facility, subject only to Permitted Liens, issued by a title insurance company qualified to do business in the State. See "RISK FACTORS — Limitations On Value of the Facility and to Remedies Under the Deed of Trust" herein.

## The Lease

Under the Lease, the Borrower will lease the Facility to MERF for use and occupancy by the School until July 1, 2034 (the “Initial Term”), subject to two options to extend the term, each for 5 years, exercisable by MERF (such date, as it may be so extended, the “Expiration Date”), at the Rent, upon and subject to all of the terms, covenants and conditions set forth in the Lease. See APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL BOND DOCUMENTS – THE LEASE” herein for definitions of “Rent,” “Base Rent,” “Additional Rent,” “Expenses” and other terms used in the Lease and “– Term – Extension Option” thereunder.

### Covenants.

Lessee covenants and agrees:

(a) *School’s Charter.* To take all reasonable actions to maintain its charter with a sponsoring entity and to take or cause to be taken any and all actions required to renew or extend the term of its charter with a sponsoring entity. As soon as practicable, Lessee covenants to provide Lessor with a copy of any notice received with regards to any sponsoring entity’s intent to renew or extend the term of any such charter or any notice of any issues which if not corrected or resolved could lead to termination or nonrenewal of any such charter. If such charter is terminated or not renewed, Lessee will use its best efforts, and will cooperate with Lessor, to assign the Lease to an entity that maintains a charter with a sponsoring entity. Further, Lessee will maintain accreditation status under the Charter Schools Act of 1992, as amended (constituting Part 26.8 of Division 4 of Title 2 of the California Education Code) and related administrative rules and, to the extent required to maintain the approval of its charter petition by the sponsoring entity, meet the student performance accountability standards stated in its charter petition.

(b) *Limitation on Disposition of Property, Plant and Equipment.* Without the consent of the Trustee, not to dispose or transfer any property, plant and equipment consisting of all or any part of the Premises, except for disposition or transfers:

(i) of property, plant and equipment no longer necessary for the operation of the Premises;

(ii) of property, plant and equipment replaced by property, plant and equipment of similar type and/or of substantially equivalent function with a substantially equivalent value; or

(iii) of property, plant and equipment sold or disposed of at a price equal to their fair market value.

(c) *No Additional Debt.* Except in connection with the issuance of Additional Bonds under the Indenture and the Loan Agreement, not to incur further or additional Indebtedness of Lessee payable out of the Gross Revenues of the School (as defined in the Lease) or to encumber any of the assets attributable to and necessary for the operation of the School.

“Indebtedness of Lessee” means any indebtedness or obligation of the Lessee (other than accounts payable and accruals), as determined in accordance with generally accepted accounting principles, including obligations under this Lease, installment purchase contracts, conditional sales contracts or other title retention contracts or rental obligations under leases which are considered capital leases under generally accepted accounting principles, payable from the Gross Revenues of the School; provided, that “Indebtedness of the Lessee” shall not include nonrecourse indebtedness or indebtedness in a principal amount of up to twenty-five percent

(25%) of the total amount of revenues from federal and State Payments to the School for the Fiscal Year concluded immediately prior to the date of calculation that is subordinate to the obligations of Lessee under the Lease.

Financial Reporting.

Lessee agrees to provide Lessor, and upon written request, the Trustee, the following information:

- (a) quarterly unaudited financial information of the School not later than 60 days from the end of each quarter,
- (b) annual budgets of the School within 60 days of their adoption,
- (c) financial information of the School within 30 days of approval by the governing board of Lessee of the School's audited financial statements, which will include calculations of the Days Cash on Hand and the Debt Service Coverage Ratio as described below,
- (d) the results of any federal or State of California testing within 60 days of receipt by the governing board of Lessee,
- (e) within 14 days of receipt, any notification or report of any potential or alleged violation of the charter for the School, and
- (f) such other information as may be reasonably requested by Lessor or Lessor on behalf of the Trustee.

Assignment to Trustee; Deposit of Rental Payments.

Lessee acknowledges and consents to the assignment by Lessor of Lessor's rights under the Lease to the Trustee and covenants and agrees to deposit all Base Rent and Additional Rent under the Lease with the Trustee under the Indenture. Lessee covenants to pay to the Trustee the Base Rent and Additional Rent due under the Lease on or before the fifteenth (15th) day of each month.

Limitation on Liens on Gross Revenues of the School.

Except as set forth in the Lease, Lessee covenants and agrees that it will not create, assume or suffer to exist any lien upon the Gross Revenues of the School and that, if a subordinate security interest is created or assumed upon the Gross Revenues of the School by Lessee, Lessee will make or cause to be made effective a provision whereby the obligations of Lessee under the Lease will be secured prior to any such indebtedness or other obligation secured by such security interest and that the revenues required by the Intercept Notice to be deposited with the Trustee under the Indenture will continue to be so deposited. A security interest in the Gross Revenues of the School on parity with the lien created by this Lease may only be created in connection with the issuance of Additional Bonds under the Indenture.

Maintenance of Separate Bank Accounts.

Lessee currently maintains one or more separate bank accounts for funds attributable to the School and will continue to maintain such separate accounts (the "School Accounts") for the term of the lease. Funds of the School shall not be comingled with other funds of the Lessee or any other person or entity. Lessee hereby grants to the Trustee and Lessor a security interest in the School Accounts.

Lessee may from time to time borrow funds from the School Accounts for its corporate purposes but any such loan must be made pursuant to a written agreement and be for a term of no more than six months. In order to enter into such loan or loans, Lessee must provide certification that the Days Cash on Hand covenant as described below requiring Days Cash on Hand of no less than 45 days is met prior to and subsequent to the loan. Except as otherwise provided herein, Lessee may not loan funds from the School Accounts to any other person or entity.

#### Days Cash on Hand.

Lessee covenants and agrees to comply with the following Days Cash on Hand requirement. "Days Cash on Hand" means: (i) the sum of Cash and Cash Equivalents in the School Accounts, as shown on the School's audited financial statements for each Fiscal Year; divided by (ii) the quotient of Operating Expenses, as shown on the audited financial statements for the preceding Fiscal Year, divided by 365. "Operating Expenses" means fees and expenses of the School, including maintenance, repair expenses, utility expenses, administrative and legal expenses, miscellaneous operating expenses, advertising costs, payroll expenses (including taxes), the cost of materials and supplies used for current operations of the School, the cost of vehicles, equipment leases and service contracts, taxes upon the operations of the School, charges for the accumulation of appropriate reserves for current expenses not annually recurrent, but which are such as may reasonably be expected to be incurred in accordance with Generally Accepted Accounting Principles, all in such amounts as reasonably determined by the School; provided, however, "Operating Expenses" shall not include depreciation, amortization or other non-cash expenses nor those expenses which are actually paid from any revenues of the School which are not Gross Revenues of the School, nor payment for improvements to the Premises which are capitalized for accounting purposes.

The Days Cash on Hand requirement shall be equal to or greater than 45 days as of June 30 in each Fiscal Year, commencing June 30, 2015, and every year thereafter. The Lessee will require its auditor to provide the Lessee and the Trustee, by no later than December 31 of each year, commencing December 31, 2015, a certification that the Days Cash on Hand requirement has been met as of the preceding June 30 test date. The foregoing is subject to the qualification that if applicable State or federal laws or regulations, or the rules and regulations of agencies having jurisdiction, shall not permit the Lessee to accumulate such level of Days Cash on Hand, then this covenant shall conform to the then-prevailing laws, rules or regulations.

If the Days Cash on Hand for any testing date is less than 45 days, then, upon the written direction of the Beneficial Owners of a majority in principal amount of the Bonds, Lessee will promptly employ an Independent Consultant acceptable to the Beneficial Owners of a majority in principal amount of the Bonds to review and analyze the operations and administration of Lessee, submit to Lessor and the Trustee written reports, and make such recommendations as to the operation and administration of Lessee as such Independent Consultant deems appropriate, including any recommendation as to a revision of the methods of operation of Lessee. Lessee agrees to consider any recommendations by the Independent Consultant and, to the fullest extent practicable and allowed by law and consistent with its covenants hereunder, to adopt and carry out such recommendations.

#### Debt Service Coverage Ratio.

Lessee covenants and agrees to budget for and maintain a Debt Service Coverage Ratio for each Fiscal Year of not less than 1.10:1.00, commencing with the Fiscal Year ending June 30, 2015. Lessee shall require its auditor to provide the Trustee by no later than December 31 of each year, commencing December 31, 2015, with a certification of the Debt Service Coverage Ratio as of the end of the preceding

Fiscal Year. If the Debt Service Coverage Ratio falls below 1.00:1.00 for any Fiscal Year ending on or after June 30, 2015, it shall constitute an Event of Default under the Lease.

“Debt Service Coverage Ratio” means, for any Fiscal Year, the ratio obtained by dividing the Net Income Available for Debt Service (as defined herein) for such Fiscal Year by the Base Rent under the Lease, as such ratio is certified to by an accountant of Lessee.

“Net Income Available for Debt Service” means, for any period of determination thereof, the Gross Revenues of the School (as defined in the Lease) for such period (not including any insurance recoveries), plus the interest earnings on moneys held in the Bond Reserve Subaccount established under the Indenture (but only to the extent that such interest earnings are transferred to the Revenue Fund) minus the total Operating Expenses of the School for such period but excluding (i) interest paid on indebtedness, (ii) any profits or losses which would be regarded as extraordinary items under Generally Accepted Accounting Principles, (iii) gain or loss in the extinguishment of indebtedness of Lessee, (iv) proceeds of the Bonds and any other indebtedness permitted by the Loan Agreement, and (v) proceeds of insurance policies, other than policies for business interruption insurance, maintained by or for the benefit of Lessee, the proceeds of any sale, transfer or other disposition of the Premises or any other of the School’s assets by Lessee, and any condemnation or any other damage award received by or owing to Lessee.

If the Debt Service Coverage Ratio for any testing date is less than 1.10:1.00, then, upon the written direction of the Beneficial Owners of a majority in principal amount of the Bonds, Lessee will promptly employ an Independent Consultant acceptable to the Beneficial Owners of a majority in principal amount of the Bonds to review and analyze the operation and administration of Lessee, submit to Lessor and the Trustee written reports, and make such recommendations as to the operation and administration of Lessee as such Independent Consultant deems appropriate, including any recommendation as to a revision of the methods of operation of Lessee; Lessee agrees to consider any recommendations by the Independent Consultant and, to the fullest extent practicable and allowed by law and consistent with its covenants hereunder, to adopt and carry out such recommendations.

#### Subordination of Collection of Management Fees

So long as the Bonds remain outstanding: (i) Lessee’s collection of management fees attributable to the School from the School Accounts for payment to third parties shall be subordinate to Lessee’s obligation to pay rent to Lessor under the Lease; (ii) Lessee’s collection of management fees attributable to the School from the School Accounts for payment to third parties shall be suspended for any such length of time as the collection of such fees would cause Lessee to fail to meet the days cash on hand and debt service coverage ratio covenants under the Lease; and (iii) during any period of time when the collection of management fees is suspended in accordance with clause (ii) above, such fees shall accrue without interest.

## **CHARTER SCHOOLS IN CALIFORNIA**

### **General**

As of Fall 2013, there were 1,130 charter schools operating in California, approximately 10% of the public schools in the State and approximately 8% of public school students Statewide. In the 2013-14 school year, 104 new charter schools opened (45 in the Los Angeles region). In 2012-13, 29 charter schools closed (21 voluntary, 7 non-renewal, 1 revocation). Six of the closures were of charter schools

authorized by the Los Angeles Unified School District, the School's authorizer (1 non-renewal, five voluntary). As of 2012-13, the Los Angeles Unified School District authorized 241 charter schools.\*

Under State law, charter schools are largely independent schools operating as part of the public school system under the exclusive control of the officers of the public schools. A charter school located in a unified school district may provide instruction in any of grades K-12, as its charter permits. A charter school is usually created or organized by a group of teachers, parents and community leaders, or a community-based organization, and is usually sponsored by an existing local public school district or county board of education. Specific goals and operating procedures for the charter school are detailed in a "charter" granted by the sponsoring board to the charter organizers.

A charter school is generally exempt from the laws governing school districts, except where specifically noted in the law. Charter schools in the State are created pursuant to Part 26.8 (commencing with Section 47600) of Division 4 of Title 2 of the State Education Code (the "Charter School Law"). The Charter School Law also requires that a public charter school be nonsectarian in its programs, admission policies, employment practices and all other operations, and prohibits the conversion of a private school to a charter school. Public charter schools may not charge tuition and may not discriminate against any pupil on the basis of ethnicity, national origin, gender or disability. State public charter schools are required to participate in the State Testing and Reporting Program.

According to the Charter School Law, the purpose of a charter school is to: (1) improve pupil learning; (2) increase learning opportunities for all pupils, with special emphasis on expanded learning experiences for pupils identified as academically low achieving; (3) encourage the use of different and innovative teaching methods; (4) create new professional opportunities for teachers, including the opportunity to be responsible for the learning program at the school site; (5) provide parents and students with expanded choices in the types of educational opportunities that are available within the public school system; (6) hold schools accountable for meeting measurable pupil outcomes and provide schools a way to shift from a rule-based to a performance-based system of accountability; and (7) provide competition within the public school system to stimulate improvements in all public schools.

Anyone may write a charter. However, for a new charter school (rather than a conversion of an existing public school), charter developers must present a petition to the governing board of the local school district (or other chartering authority) containing the signatures of either: (1) a number of teachers meaningfully interested in teaching at the school equal to at least 50 percent of the number of teachers the charter school estimates will be employed, or (2) a number of parents representing at least 50 percent of the number of pupils expected to enroll at the school in its first year. For conversion schools, the Charter School Law requires signatures of at least 50 percent of the teachers at the school to be converted. Pupils are not required to attend a charter school nor may teachers be compelled to teach there. Charters are granted for a maximum term of five years, and may be renewed for new five-year terms without limitation upon satisfaction of certain criteria, as further described below.

Generally, each charter school is funded to its statutory entitlement after the local contribution is taken into account. Local funding comes from the chartering school district or other sponsoring local education agency in lieu of property taxes (generally funded from the school district's own property tax receipts), while the State funds the balance directly through the county office of education. The proportion coming from the State varies from district to district depending upon the amount of local property taxes collected. In addition, charter schools receive State categorical block grant funding and lottery funds based upon pupil attendance, and may be eligible for other special programmatic aid from State and federal grants. The Local Control Funding Formula, is being implemented for the first time in

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\* Source: California Charter Schools Association.

fiscal year 2013-14, will substantially change the way funds are allocated to charter schools. See “STATE FUNDING OF EDUCATION – General – 2013-14 State Budget” and “STATE FUNDING OF EDUCATION – Allocation of State Funding to Charter Schools” herein. See “RISK FACTORS – Specific Risks of Charter Schools” herein.

### **Chartering Authority**

Under the Charter School Law, the local school district governing board serves as the primary chartering authority. A petitioner may seek approval of a charter from a county board of education if the pupils to be served are pupils who would normally be provided direct education and related services by the county office of education. A petitioner may seek approval directly from the State Board of Education only if the State Board of Education finds that the proposed state charter school will provide instructional services of statewide benefit that cannot be provided by a charter school operating in only one school district or county. Petitioners may request the county board of education or the State Board of Education to review a charter petition if the petition has been previously denied by the local school district governing board. The Los Angeles Unified School District is the authorizer for the School. See “INTRODUCTION – The Authorizer” and APPENDIX A – “CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION – The School.”

### **Elements of a Charter Petition**

Each charter petition, at a minimum, must contain reasonably comprehensive descriptions of each of sixteen required elements. They are:

1. A description of the educational program of the charter school.
2. The measurable pupil outcomes identified for use by the charter school.
3. The method by which pupil progress in meeting those pupil outcomes is to be measured.
4. The charter school’s governance structure, including parental involvement.
5. The qualifications to be met by individuals employed by the charter school.
6. Procedures to ensure health and safety of pupils and staff.
7. The means by which the charter school will achieve racial and ethnic balance among pupils, reflective of the general population residing in the chartering district.
8. Admission requirements, if applicable.
9. The manner in which annual financial audits will be conducted, and the manner in which audit exceptions and deficiencies will be resolved to the satisfaction of the chartering authority.
10. The procedures by which pupils may be suspended or expelled.
11. Provisions for employee coverage under the State Teachers’ Retirement System, the Public Employees’ Retirement System, or federal social security.
12. The public school alternatives for pupils residing within the district who choose not to attend charter schools.

13. A description of the rights of any employee of the school district upon leaving the employment of the school district to work in a charter school, and of any rights of return to the school district after employment at a charter school.

14. The procedures to be followed by the charter school and the entity granting the charter to resolve disputes relating to provisions of the charter.

15. A declaration of whether or not the charter school will be deemed the exclusive public school employer of the employees of the charter school for purposes of the Educational Employment Relations Act.

16. A description of the procedures for closure of the school and disposition of assets.

Under the additional accountability requirements incorporated into the Charter School Law in October 2003, districts or other agencies that have charter authority must identify a contact person for charter schools, visit each charter school at least once a year, and ensure that charter schools submit all required reports (including fiscal reports that must be sent four times a year to the district and local county office of education). In addition, the district must monitor the fiscal condition of its charter schools and notify the State Department of Education whenever a charter is granted, denied, revoked, or a charter school will cease operation. The Charter School Law now also requires that charter schools show a certain level of academic performance to have their charters renewed.

### **Charter Management Organizations**

As the number of charter schools operating pursuant to the Charter School Law has increased over time, non-profit organizations have been established, referred to as charter management organizations (“CMOs”), to manage the operations of multiple charter schools for the purpose of achieving certain economic and operational efficiencies. CMOs centralize or share certain functions and resources among multiple charter schools, including but not limited to accounting, human resources, marketing, purchasing, property management and administration. CMOs may operate at the regional or statewide level. ACCORD functions as a CMO for the School. See APPENDIX A – “CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION” herein.

### **Charter Revocation**

A charter may be revoked if the charter-granting authority finds, based on substantial evidence, that a charter school (i) has committed a material violation any of the conditions, standards or procedures set forth in its charter, or (ii) has failed to meet or to pursue any of the student outcomes identified in its charter, or (iii) has failed to meet generally accepted accounting principles, or engages in fiscal mismanagement, or (iv) has violated any provision of law. Prior to revoking a charter, the charter granting authority must notify the charter school of the violation, afford the charter school a reasonable opportunity to remedy the violation, and, upon failure to do so, give written notice of intent to revoke and hold a public hearing on the matter. An adverse decision by a school district governing board may be appealed to the county board of education, and an adverse decision by the county board directly or on appeal may be appealed to the State Board of Education (the “State Board”).

In addition, the State Board, whether or not it is the charter granting authority, may take action based on the recommendation of the State Superintendent of Public Instruction, including but not limited to revocation of a school’s charter, upon a finding of (i) gross financial mismanagement that jeopardizes the financial stability of the charter school, (ii) illegal or substantially improper use of charter school



funds for the personal benefit of any officer, director or fiduciary of the charter school, or (iii) substantial and sustained departure from measurably successful practices such that continuing departure would jeopardize the education development of the school's pupils. Regulations promulgated by the State Board that became effective February 13, 2011 require the California Department of Education to identify and notify the State Board of each charter school that is determined to warrant action pursuant to clause (iii) of the immediately preceding sentence by November 1 of each year. Under these regulations, charter schools so notified are required to be given an opportunity to submit written information as to why its charter should not be revoked. Any resulting action to revoke a charter is effective at the end of the fiscal year in which the action is taken, unless the State Board identifies departures at the school that are so significant as to be cause for immediate revocation and closure of the charter school. The regulations require the State Board to hold a public hearing to consider action including but not limited to charter revocation not later than March 31. See "RISK FACTORS – Specific Risks of Charter Schools – Non-Renewal or Revocation of Charters" herein. MERF has not received any notice from the State Board or the School's chartering authority, the Los Angeles Unified School District, regarding any violation or proposal to revoke the School's charter or of any other violation requiring corrective action.

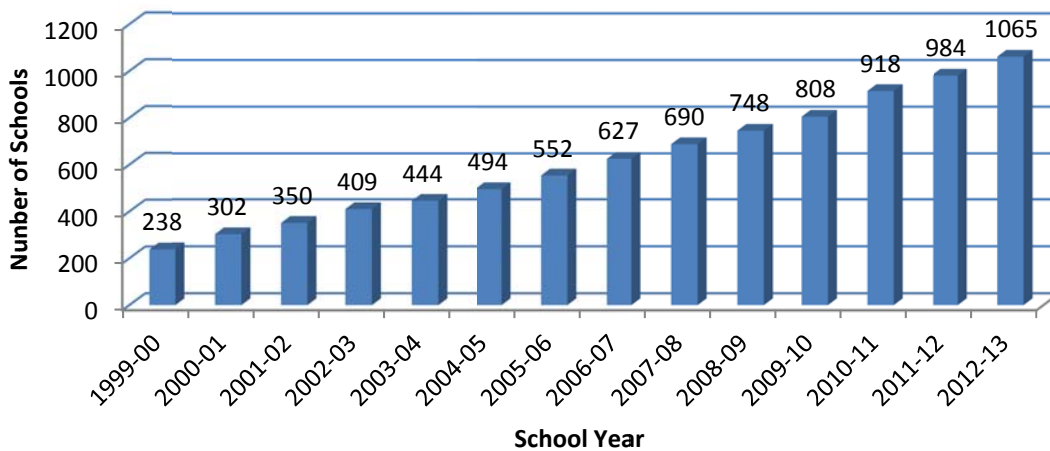
### **Amendments to the Charter School Law**

The Legislature has amended the Charter School Law frequently since its initial enactment in 1992, and legislative and public attitudes are still evolving. The Borrower has no control over State legislative or regulatory decision making that could affect its operations or ongoing funding sources. For example, currently pending legislation affecting the Charter Schools Act and related law include: Assembly Bill 913 ("AB 913") which would expressly state that a charter school is subject to the Ralph M. Brown Act, the California Public Records Act, Government Code 1090, and the Political Reform Act; Assembly Bill 1979 ("AB 1979") which would set the limit of the total amount of revenue bonds that may be issued and outstanding at any time at \$4,400,000,000 for purposes of the California School Finance Authority Act; Senate Bill 1166 ("SB 1166") which would require that, commencing with the 2014-15 fiscal year, school districts, including charter schools, would receive state reimbursement for the full cost of the home-to-school transportation of pupils; and Senate Bill 1263 ("SB 1263") which would eliminate the authority of a charter school to locate outside the jurisdiction or geographic boundaries of the chartering school district. Neither the Borrower nor any other party described herein can predict whether AB 913, AB 1979, SB 1166, or SB 1263 will be enacted into law.

### **Growth in Charter Schools in California**

The State of California has the largest concentration of charter schools in the nation, with over 484,000 students enrolled in charter schools for the 2012-13 school year, according to the California Charter Schools Association ("CCSA"). The CCSA also reported that the number of charter schools in California grew by 81 in the 2012-13 school year, and by 104 in the 2013-14 school year, including the addition of 40 in the Los Angeles region in 2012-13 and an additional 45 in 2013-14. The total number of charter schools in California was 1,065 in 2012-13 (of which 228 were in Los Angeles Unified School District) and 1,130 in 2013-14. According to CCSA, in 2012-13 approximately 15,000 students in the Los Angeles area were on waiting lists to attend a charter school.

## Total Charter Schools in California



Source: Public Charter School Dashboard, National Alliance for Public Charter Schools.

## STATE FUNDING OF EDUCATION

### General

The Charter School Law provides that the legislature intended “each charter school be provided with operational funding that is equal to the total funding that would be available to a similar school district servicing a similar pupil population . . .” As is true for school districts in the State, charter schools’ revenue is derived primarily from two sources: a State portion funded from the State’s general fund and a locally generated portion derived from each sponsoring school district’s share of the local ad valorem property tax. Decreases in State revenues, or in the legislative appropriations made to fund education, may significantly affect charter schools’ operations.

*State Budget Process.* According to the State Constitution, the Governor must propose a budget to the State Legislature no later than January 10 of each year, and a final budget must be adopted no later than June 15. Historically, the budget required a two-thirds vote of each house of the State Legislature for passage. However, on November 2, 2010, the State’s voters approved Proposition 25, which amended the State Constitution to lower the vote requirement necessary for each house of the State Legislature to pass a budget bill and send it to the Governor. Specifically, the vote requirement was lowered from two-thirds to a simple majority (50% plus one) of each house of the State Legislature. The lower vote requirement also would apply to trailer bills that appropriate funds and are identified by the State Legislature “as related to the budget in the budget bill.” The budget becomes law upon the signature of the Governor, who may veto specific items of expenditure. Under Proposition 25, a two-thirds vote of the State Legislature is still required to override any veto by the Governor. School district budgets must generally be adopted by July 1, and revised by the school board within 45 days after the Governor signs the budget act to reflect any changes in budgeted revenues and expenditures made necessary by the adopted State budget. The Governor signed the fiscal year 2013-14 State budget on June 27, 2013. See “2013-14 State Budget” below.

When the State budget is not adopted on time, basic appropriations and the categorical funding portion of each charter school’s State funding are affected differently. Under the rule of *White v. Davis*

(also referred to as *Jarvis v. Connell*), a State Court of Appeal decision reached in 2002, there is no constitutional mandate for appropriations to charter schools, school districts without an adopted budget or emergency appropriation, and funds for State programs cannot be disbursed by the State Controller until that time unless the expenditure is (i) authorized by a continuing appropriation found in statute, (ii) mandated by the State Constitution (such as appropriations for salaries of elected State officers), or (iii) mandated by federal law (such as payments to State workers at no more than minimum wage). The State Controller has consistently stated that basic State funding for schools is continuously appropriated by statute, but that special and categorical funds may not be appropriated without an adopted budget. Should the State Legislature fail to pass a budget or emergency appropriation before the start of any fiscal year, the Borrower might experience delays in receiving certain expected revenues. See “RISK FACTORS.”

State income tax and other receipts can fluctuate significantly from year to year, depending on economic conditions in the State and the nation. Because funding for education is closely related to overall State income, as described in this section, funding levels can also vary significantly from year to year, even in the absence of significant education policy changes. A brief description of the adopted State budget for 2013-14 is included below; however, no prediction can be made as to how State income or State education funding will vary over the entire term to maturity of the Bonds, and neither the Borrower or the Authority takes any responsibility for informing owners of the Bonds as to any such annual fluctuations. Information about the State budget and State spending for education is regularly available at various State-maintained websites. Text of proposed and adopted budgets may be found at the website of the Department of Finance, [www.dof.ca.gov](http://www.dof.ca.gov), under the heading “California Budget.” An impartial analysis of the budget is posted by the Office of the Legislative Analyst at [www.lao.ca.gov](http://www.lao.ca.gov). In addition, various State of California official statements, many of which contain a summary of the current and past State budgets and the impact of those budgets on school districts in the State, may be found at the website of the State Treasurer, currently located at [www.treasurer.ca.gov](http://www.treasurer.ca.gov), and the Electronic Municipal Market Access (EMMA) website of the Municipal Securities Rulemaking Board, currently located at <http://emma.msrb.org>. The information referred to is prepared by the respective State agency maintaining each website and not by the Borrower or the Authority, and neither the Borrower nor the Authority can take any responsibility for the continued accuracy of these internet addresses or for the accuracy, completeness or timeliness of information posted there, and such information is not incorporated herein by these references. The information referred to above is provided solely for convenience of reference and should not be relied upon in making an investment decision with respect to the Bonds.

*Aggregate State Education Funding.* The Proposition 98 guaranteed amount for education is based on prior-year funding, as adjusted through various formulas and tests that take into account State proceeds of taxes, local property tax proceeds, school enrollment, per-capita personal income, and other factors. The State’s share of the guaranteed amount is based on State general fund tax proceeds and is not based on the general fund in total or on the State budget. The local share of the guaranteed amount is funded from local property taxes. The total guaranteed amount varies from year to year and throughout the stages of any given fiscal year’s budget, from the Governor’s initial budget proposal to actual expenditures to post-year-end revisions, as better information regarding the various factors becomes available. Over the long run, the guaranteed amount will increase as enrollment and per capita personal income grow.

If, at fiscal year-end, the guaranteed amount is calculated to be higher than the amount actually appropriated in that year, the difference becomes an additional education funding obligation, referred to as “settle-up.” If the amount appropriated is higher than the guaranteed amount in any year, that higher funding level permanently increases the base guaranteed amount in future years. The Proposition 98 guaranteed amount is reduced in years when general fund revenue growth lags personal income growth, and may be suspended for one year at a time by enactment of an urgency statute. In either case, in subsequent years when State general fund revenues grow faster than personal income (or sooner, as the

Legislature may determine), the funding level must be restored to the guaranteed amount, the obligation to do so being referred to as “maintenance factor.”

In recent years, the State’s response to fiscal difficulties has had a significant impact on Proposition 98 funding and settle-up treatment. The State has sought to avoid or delay paying settle-up amounts when funding has lagged the guaranteed amount. In response, teachers’ unions, the State Superintendent and others sued the State or Governor in 1995, 2005, 2009 and 2011 to force them to fund schools in the full amount required. The settlement of the 1995 and 2005 lawsuits has so far resulted in over \$4 billion in accrued State settle-up obligations. However, legislation enacted to pay down the obligations through additional education funding over time, including the Quality Education Investment Act of 2006, have also become part of annual budget negotiations, resulting in repeated adjustments and deferrals of the settle-up amounts.

The State has also sought to preserve general fund cash while avoiding increases in the base guaranteed amount through various mechanisms: by treating any excess appropriations as advances against subsequent years’ Proposition 98 minimum funding levels rather than current year increases; by temporarily deferring apportionments of Proposition 98 funds from one fiscal year to the next; by permanently deferring the year-end apportionment from June 30 to July 2 (which will be paid on July 15 in 2014, as part of Proposition 30, passed by the voters in November of 2012); by suspending Proposition 98; and by proposing to amend the Constitution’s definition of the guaranteed amount and settle-up requirement under certain circumstances. The Governor’s 2013-14 budget reverses many of these trends, for example, by eliminating certain deferrals. See “2013-14 State Budget” below.

*Prohibitions on Diverting Local Revenues for State Purposes.* Beginning in 1992-93, the State satisfied a portion of its Proposition 98 obligations by shifting part of the property tax revenues otherwise belonging to cities, counties, special districts, and redevelopment agencies, to school and college districts through a local Educational Revenue Augmentation Fund (“ERAF”) in each county. Local agencies, objecting to invasions of their local revenues by the State, sponsored a statewide ballot initiative intended to eliminate the practice. In response, the State Legislature proposed an amendment to the State Constitution, which the State’s voters approved as Proposition 1A at the November 2004 election. That measure was generally superseded by the passage of a new initiative constitutional amendment at the November 2010 election, known as “Proposition 22.”

The effect of Proposition 22 is to prohibit the State, even during a period of severe fiscal hardship, from delaying the distribution of tax revenues for transportation, redevelopment, or local government projects and services. The State is now prevented from redirecting redevelopment agency property tax increment to any other local government, including school districts, or from temporarily shifting property taxes from cities, counties and special districts to schools, as in the ERAF program. This was originally intended to, among other things, stabilize local government revenue sources by restricting the State’s control over local property taxes. The passage of Proposition 22 has also stopped the State from using fuel tax revenues to pay debt service on most State bonds for transportation projects, reducing the amount of State general fund resources available for other purposes, including education.

Prior to the passage of Proposition 22, the State invoked Proposition 1A to divert \$1.935 billion in local property tax revenues in 2009-10 from cities, counties, and special districts to the State to offset State general fund spending for education and other programs, and included another diversion in the adopted 2009-10 State budget of \$1.7 billion in local property tax revenues from local redevelopment agencies, which local redevelopment agencies have now been dissolved. Redevelopment agencies sued the State over this latter diversion. However, the lawsuit was decided against the California Redevelopment Association on May 1, 2010. Because Proposition 22 reduces the State’s authority to use or shift certain revenue sources, fees and taxes for State general fund purposes, the State will have to take

other actions to balance its budget in some years—such as reducing State spending or increasing State taxes, and school and community college districts that receive Proposition 98 or other funding from the State will be more directly dependent upon the State’s general fund. See “Dissolution of Redevelopment Agencies” below.

*2013-14 State Budget.* The Governor signed the fiscal year 2013-14 State budget (the “2013-14 State Budget”) on June 27, 2013. The 2013-14 State Budget represents a multiyear plan that maintains a \$1.1 billion reserve and pays down certain budgetary debt. The 2013-14 State Budget provides for \$97.1 billion in revenues and transfers for fiscal year 2013-14 (down slightly from the \$98.2 billion estimated for fiscal year 2012-13), and \$96.3 billion in total expenditures for fiscal year 2013-14 (up slightly from the \$95.7 billion estimates for fiscal year 2012-13). However, unlike recent years, the State enters fiscal year 2013-14 with a positive prior year general fund balance, approximately \$872 million, as compared to a negative general fund balance of \$1.7 billion at the start of fiscal year 2012-13. The 2013-14 State Budget, accordingly, is able to set aside a \$1.1 billion reserve in a special fund for economic uncertainties.

The 2013-14 State Budget projects that budgetary debt, which was approximately \$35 billion at the end of fiscal year 2010-11 and \$27 billion at the end of fiscal year 2012-13, will be reduced to less than \$5 billion by the end of fiscal year 2016-17. Although the 2013-14 State Budget is a balanced budget, the 2013-14 State Budget notes that substantial risks, uncertainties and liabilities remain, including the pace of the economic recovery, the State’s needs to address its other significant liabilities and the federal budget for federal fiscal year 2014.

With the passage of Proposition 30, The Schools and Local Public Safety Protection Act (the “Temporary Tax Measure”), the 2013-14 State Budget reinvests in, rather than cuts, education funding. The Temporary Tax Measure increased the personal income tax rates on the State’s highest income taxpayers by up to three percent for a period of seven years beginning with the 2012 tax year, and increased the sales tax by one-quarter percent for a period of four years beginning on January 1, 2014. For kindergarten through twelfth grade (“K-12”) education, the 2013-14 State Budget provides \$55.3 billion (or \$8,220 per student) in Proposition 98 funding in fiscal year 2013-14, which is slightly lower than the \$56.5 billion estimated in fiscal year 2012-13 but an increase of more than \$8 billion (or \$1,045 per student) from fiscal year 2011-12 levels. The 2013-14 State Budget projects \$67.1 billion (or \$10,010 per student) in Proposition 98 funding in fiscal year 2016-17. Total funding under the 2013-14 State Budget for all K-12 education in fiscal year 2013-14 is approximately \$70 billion.

The 2013-14 State Budget also contains a new formula for funding the school finance system (the “Local Control Funding Formula”). The Local Control Funding Formula is designed to increase local control and flexibility, reduce State bureaucracy and better allocate resources based on student needs. The Local Control Funding Formula would replace the existing revenue limit funding system and most categorical programs. See “–Local Control Funding Formula” herein for more information.

Certain budget adjustments for K-12 programs include the following:

- **Local Control Funding Formula.** An increase of \$2.1 billion in Proposition 98 general funds for school districts and charter schools, and \$32 million in Proposition 98 general funds for county offices of education, to support first-year funding provided through the Local Control Funding Formula.
- **Common Core Implementation.** An increase of \$1.25 billion in one-time Proposition 98 general funds to support the implementation of the Common Core, which are new standards for evaluating student achievement in English-language arts and mathematics. Such funding will be distributed to local education agencies on the basis of enrollment to support necessary investments in

professional development, instructional materials and technology. Local education agencies will be required to develop a plan to spend this money over the next two years and to hold a public hearing on such plan.

- Career Technical Education Pathways Grant Program. An increase of \$250 million in Proposition 98 general funds for one-time competitive capacity-building grants for K-12 school districts and community colleges to support programs focused on work-based learning. K-12 schools and community colleges must obtain funding commitments from program partners to support ongoing program costs.

- K-12 Mandates Block Grant. An increase of \$50 million in Proposition 98 general funds to reflect the inclusion of the Graduation Requirements mandate within the block grant program. This increase will be distributed to school districts, county offices of education and charter schools with enrollment in grades 9-12.

- K-12 Deferrals. An increase of \$1.6 billion in Proposition 98 general funds in fiscal year 2012-13 and an increase of \$242.3 million in Proposition 98 general funds in fiscal year 2013-14 for the repayment of inter-year budgetary deferrals. When combined, total funding over such two-year will reduce K-12 inter-year deferrals to \$5.6 billion by the end of fiscal year 2013-14.

- Special Education Funding Reform. The 2013-14 State Budget includes several consolidations for various special education programs in an effort to simplify special education finance and provide Special Education Local Plan Areas with additional funding flexibility.

With respect to the implementation of Proposition 39 (The California Clean Energy Jobs Act), which was approved at the November 6, 2012 election, the 2013-14 State Budget allocates \$381 million in Proposition 98 general funds to K-12 local education agencies to support energy efficiency projects approved by the California Energy Commission. Of this amount, 85% will be distributed based on ADA and 15% will be distributed based on free and reduced-price meal eligibility. The 2013-14 State Budget establishes minimum grant levels of \$15,000 and \$50,000 for small and exceptionally small local education agencies and allows these agencies to receive an advance on a future grant allocation. Other local education agencies would receive the greater of \$100,000 or their weighted distribution amount. The 2013-14 State Budget also provides \$28 million for interest-free revolving loans to assist eligible energy projects at schools and community colleges.

*Governor's Proposed 2014-15 Budget.* On January 9, 2014, the Governor released his proposed State budget for fiscal year 2014-15 (the "2014-15 Proposed Budget"). The following information is derived from the State Department of Finance's summary of the 2014-15 Proposed Budget.

The 2014-15 Proposed Budget assumes, for fiscal year 2013-14, total general fund revenues of \$100.1 billion and total expenditures of \$98.5 billion. The State is projected to end the 2013-14 fiscal year with a general fund surplus of \$3.3 billion. For fiscal year 2014-15, the 2014-15 Proposed Budget assumes total general fund revenues of \$104.5 billion and authorizes expenditures of \$106.8 billion. The 2014-15 Proposed Budget also authorizes a deposit of \$1.6 billion to the Budget Stabilization Account. The State is projected to end the 2014-15 fiscal year with a \$967 million general fund surplus.

The 2014-15 Proposed Budget retroactively increases the Proposition 98 minimum funding guarantee for fiscal year 2012-13 to \$58.3 billion, an increase of \$1.8 billion over the revised level set by the 2013-14 Budget. For fiscal year 2013-14, the Proposition 98 minimum funding guarantee is revised to \$56.8 billion, an increase of \$1.5 billion over the prior level. The 2014-15 Proposed Budget allocates this two-year increase, totaling \$3.3 billion, to retire outstanding K-12 apportionment deferrals.

The growth in prior year revenues also drives a growth in the minimum funding guarantee for fiscal year 2014-15, which the Proposed Budget sets at \$61.6 billion. Other significant proposals or adjustments with respect to K-12 education funding include the following:

- *Repayment of K-12 Deferrals.* An increase of \$2.2 billion in Proposition 98 funding which, together with the \$3.3 billion increase in funding allocable to fiscal years 2012-13 and 2013-14 (as discussed above), would be used to eliminate all remaining outstanding K-12 apportionment deferrals.
- *Local Control Funding Formula.* \$4.5 billion of Proposition 98 funding to school districts and charter schools to continue the implementation of the LCFF, reflecting an increase of 10.9% from the prior year. This amount would be sufficient to eliminate more than 28% of the remaining funding gap. The Governor also proposes legislation to create a continuous appropriation for LCFF funding in future years. With respect to county offices of education, the Proposed Budget provides an increase of \$25.9 million of Proposition 98 funding to continue the implementation of the LCFF.
- *Common Core.* An increase of \$46.5 million in Proposition 98 funding to implement Assembly Bill 484 (Stats. 2013, Chapter 489), which established a revised student assessment system aligned with the new Common Core standards.
- *Charter Schools.* An increase of \$74.3 million in Proposition 98 funding to support a projected growth in charter school ADA.
- *Categorical Programs.* \$33.3 million to support a 0.86% COLA for categorical programs outside of the LCFF, including the Special Education, Child Nutrition, American Indian Education Centers, and American Indian Early Childhood Education Programs.
- *Special Education.* A decrease of \$16.2 million in Proposition 98 funding to reflect a decline in special education ADA.
- *Budget Stabilization Account.* As part of the 2014-15 Proposed Budget, the Governor proposes a constitutional amendment to strengthen existing provisions of law that require the State to adopt a balanced budget in each year and deposit a portion of State general fund revenues into a Budget Stabilization Account. A key component of this constitutional amendment would be the creation of a Proposition 98 reserve account to smooth out year-to-year school spending. The Governor's proposed amendment would not make changes to the guaranteed funding levels required under Proposition 98.
- *Proposition 39 Implementation.* The 2014-15 Proposed Budget allocated \$316 million of funds derived from Proposition 39 state corporate tax revenues to K-12 school districts to fund energy efficiency project grants. The 2014-15 Proposed Budget also allocates \$5 million of such funds to the California Conservation Corps for continued technical assistance to K-12 school districts.
- *School Facilities Funding.* The 2014-15 Proposed Budget authorizes the transfer of \$211 million of remaining State bonding authority from specialized programs to the school facility core new construction and modernization programs. The 2014-15 Proposed Budget also dedicates \$188.1 million of one-time Proposition 98 funding to the State's Emergency Repair Program to provide grants or reimbursement to local educational agencies for the cost of repairing or replacing building systems that pose a health and safety threat to students and staff at eligible school sites.

The complete 2013-14 State Budget and the 2014-15 Proposed Budget is available from the California Department of Finance website at [www.dof.ca.gov](http://www.dof.ca.gov). Neither the Borrower nor the Authority takes any responsibility for the continued accuracy of such internet address or for the accuracy,

completeness or timeliness of information posted therein, and such information is not incorporated herein by such reference.

*Local Control Funding Formula.* The Local Control Funding Formula replaces the prior revenue limit funding system and most categorical programs, and distributes combined resources to school districts through a base revenue limit funding grant (“Base Grant”) per unit of ADA with additional supplemental funding allocated to local educational agencies based on their proportion of English language learners, students from low-income families and foster youth, beginning with fiscal year 2013-14. The Local Control Funding Formula has an eight-year implementation program to incrementally close the gap between actual funding and the target level of funding, as described below. The Local Control Funding Formula includes the following components:

- A Base Grant for each local education agency, equivalent to \$7,643 per unit of ADA in fiscal year 2013-14. Such Base Grant per unit of ADA, adjusted by grade span variation and to be adjusted annually for cost-of-living, is as follows: \$6,845 for grades K-3, \$6,947 for grades 4-6, \$7,154 for grades 7-8 and \$8,289 for grades 9-12 (the “Target Base Grant”). This amount includes an adjustment of 10.4% to the Base Grant to support lowering class sizes in grades K-3, and an adjustment of 2.6% to reflect the cost of operating career technical education programs in grades 9-12.
- A 20% supplemental grant for the unduplicated number of English language learners, students from low-income families and foster youth to reflect increased costs associated with educating those students.
- An additional concentration grant of up to 22.5% of a local education agency’s Base Grant, based on the number of English language learners, students from low-income families and foster youth served by the local education agency that comprise more than 55% of enrollment.
- An Economic Recovery Target (the “ERT”) that is intended to ensure that almost every local education agency receives at least their pre-recession funding level (i.e., the fiscal year 2007-08 revenue limit per unit of ADA), adjusted for inflation, at full implementation of the Local Control Funding Formula. Upon full implementation, local education agencies would receive the greater of the Target Base Grant or the ERT.

Of the projected \$25 billion in new funding to be invested through the Local Control Funding Formula over the next eight years, the vast majority of new funding will be provided for Base Grants. Specifically, of every dollar invested through the Local Control Funding Formula, 84 cents will go to Base Grants, 10 cents will go to supplemental grants and 6 cents will go to concentration grants.

Under the new formula, for “basic aid districts,” local property tax revenues would be used to offset up to the entire allocation under the new formula. However, “basic aid districts” would continue to receive the same level of State aid as allocated in fiscal year 2012-13.

All school districts, county offices of education and charter schools will be required to develop and adopt local control and accountability plans, which will identify local goals in areas that are priorities for the State, including pupil achievement, parent engagement and school climate. Such local control and accountability plans are to be developed in accordance with a template to be provided by the State Board of Education. County superintendents will review and provide support to the school districts under their jurisdiction, while the Superintendent of Public Instruction will perform a corresponding role for county offices of education. In addition the 2013-14 State Budget creates the California Collaborate for



Education Excellence (the “Collaborative”) to advise and assist local education agencies in achieving the goals identified in their plans. For local education agencies that continue to struggle in meeting their goals, and when the Collaborative indicates that additional intervention is needed, the Superintendent of Public Instruction would have authority to make changes to a local education agency’s plan. For charter schools, the charter authorizer will be required to consider revocation of a charter if the Collaborative finds that the inadequate performance is persistent and acute as to warrant revocation.

*May Revision to Proposed 2014-15 State Budget.* On May 13, 2014, the Governor released the “Governor’s Budget May Revision 2014-15” (the “May Revise”), which outlines proposed revisions to the 2014-15 Proposed State Budget. The May Revise projects a net increase of \$2.4 billion in expected revenues across fiscal years 2012-13 through 2014-15. More specifically, the May Revise projects \$513 million less in revenues in fiscal year 2012-13, and \$2 billion and \$843 million more in revenues in fiscal years 2013-14 and 2014-15, respectively. The significant bump in fiscal year 2013-14 is primarily a result of increased projections in personal income tax, much of which is associated with higher annual bonus payments and one-time shifts due to federal tax policy changes in 2012. Under the May Revise, total State general fund revenues are now projected to be \$102.2 billion and \$106.9 billion (including the amounts proposed to be transferred to the Rainy Day Fund) for fiscal years 2013-14 and 2014-15, respectively. Projected expenditures have also increased under the May Revise and offset, in part, the projected additional revenues. For example, total State general fund expenditures in fiscal year 2014-15 are now projected to be \$107.8 billion (as compared to \$106.8 billion under the 2014-15 Proposed State Budget). Although the May Revise projects a balanced budget and sets aside a reserve, it notes a number of major risks that threaten the State’s fiscal stability, including fiscal debts, growing long-term liabilities and lingering uncertainties regarding the costs of the federal Affordable Care Act.

The May Revise maintains the principle of paying down debt (by more than \$11 billion in fiscal year 2014-15 and eliminating all budgetary debt by fiscal year 2017-18) and includes an additional \$100 million to repay a portion of existing mandate reimbursement claims that have been owed to local governments since at least 2004. The May Revise also maintains the proposal to set aside \$1.6 billion in the Rainy Day Fund, but reduces the amount to be set aside in the general fund traditional reserve from \$693 million to \$528 million. The constitutional amendments for the Rainy Day Fund, as further described in the May Revise, are being submitted to the voters in November of 2014 and would take effect in fiscal year 2015-16. No assurances can be provided that such constitutional amendments relating to the Rainy Day Fund would be approved by the voters.

Certain factors resulting in the increase in projected costs and expenditures under the May Revise include: (a) rising health care costs associated with the substantial increase in Covered California and Medi-Cal enrollment (projected to be \$1.2 billion more over two years than what was expected in the 2014-15 Proposed State Budget); (b) an additional \$121 million in general fund spending in fiscal year 2014-15 for drought-related expenditures; and (c) an additional \$430 million (of which \$254 million is general fund) in costs in fiscal year 2014-15 based on the new California Public Employees’ Retirement System (“CalPERS”) assumptions regarding longer life expectancy of retirees. The May Revise also proposes a plan built on shared responsibility among school and community college districts, the State and teachers to eliminate the California State Teachers’ Retirement System (“CalSTRS”) unfunded liability (estimated at \$74.4 billion) in just over 30 years. Such plan proposes payment of an additional \$450 million (of which \$73.2 million is general fund) in fiscal year 2014-15. Under the plan, school and community college districts would pay about 70% of costs, the State would pay about 20% of costs and teachers would pay the remaining 10% of costs.

With respect to K-12 Education, Proposition 98 funding obligations are projected to increase across fiscal years 2012-13 through 2014-15 driven by the changes in projected general fund revenues. Under the May Revise, as compared to the 2014-15 Proposed State Budget, Proposition 98 funding is

projected to decrease by \$547 million in fiscal year 2012-13 due to a decrease in revenues in such fiscal year, increase by approximately \$1.5 billion in fiscal year 2013-14 due to higher revenues and enrollment growth in such fiscal year, and decrease by approximately \$700 million in fiscal year 2014-15 due to slower year-over-year general fund revenue growth and a decrease in local revenues. As a result of such changes, the revised Proposition 98 guarantee levels for fiscal years 2012-13, 2013-14 and 2014-15 are projected to be \$57.8 billion, \$58.3 billion and \$60.9 billion, respectively. The May Revise continues the commitment from the 2014-15 Proposed State Budget to repay all existing inter-year budgetary deferrals for school districts, and provide a second-year investment of \$4.5 billion for implementing the LCFF.

Certain budget adjustments for K-12 programs under the May Revise include the following:

- *Independent Study.* A series of changes to the 2014-15 Proposed State Budget proposal to streamline and expand the instructional opportunities available through independent study.
- *K-12 High Speed Internet Access.* An increase of \$26.7 million in one-time Proposition 98 general funds to provide technical assistance and grants to local educational agencies, based on an assessment by the K-12 High Speed Network, to address the technology requirements necessary for successful implementation of the Common Core standards.
- *K-12 Deferrals.* A combined net increase of \$742.2 million in one-time Proposition 98 general funds (as compared to the 2014-15 Proposed State Budget) attributable to fiscal years 2012-13 and 2013-14 to accelerate the repayment of inter-year budgetary deferrals in those years. This acceleration will be offset by a reduction of \$742.2 million in ongoing Proposition 98 general funds for proposed deferral repayments in fiscal year 2014-15. When combined, total funding over the three-year period would eliminate all K-12 inter-year deferrals.
- *LCFF: Unduplicated Pupils.* To address certain challenges raised by local educational agencies collecting income eligibility forms to determine if a student qualified for a free or reduced-price meal, the May Revise proposes certain changes relating to the calculation of unduplicated pupils under the LCFF.
- *Proposition 39.* For fiscal years 2013-14 through 2017-18, the California Clean Energy Jobs Act (Proposition 39) requires half of the increased revenues, up to \$550 million per year, to be used to support energy efficiency projects. The May Revise decreases the amount of energy efficiency funds available to K-12 schools in fiscal year 2014-15 by \$9 million to \$307 million to reflect reduced revenue estimates.
- *Local Property Tax Adjustments.* An increase of \$83.9 million in Proposition 98 general funds in fiscal year 2014-15 for school districts, special education local plan areas, and county offices of education as a result of lower offsetting property tax revenues.
- *ADA.* An increase of \$103.1 million in fiscal year 2013-14 and an increase of \$121.1 million in fiscal year 2014-15 for school districts, charter schools and county offices of education as a result of an increase in projected ADA in both years.
- *Categorical Program Growth.* An increase of \$15.3 million in Proposition 98 general funds for selected categorical programs based on updated estimates of projected ADA growth.
- *Cost-of-Living Adjustments.* A decrease of \$258,000 in Proposition 98 general funds to selected categorical programs based on a revised COLA factor of 0.85% for fiscal year 2014-15.

- *K-12 Mandates Block Grant.* An increase of \$1.6 million in Proposition 98 general funds to align mandate block funding with revised ADA estimates. This additional funding is required to maintain statutory block grant funding rates assuming 100% program participation.
- *K-12 Mandates Claims Process.* An increase of \$5,000 in Proposition 98 general funds to reflect the addition of five mandates to the mandate claiming process (Parental Involvement Programs, Williams Case Implementation I, II, and III, and Developer Fees). An additional \$1,000 is provided for both the existing Student Records and Graduation Requirements mandates, which were inadvertently omitted from the claims process budget bill item last year.

The complete May Revise is available from the California Department of Finance website at [www.dof.ca.gov](http://www.dof.ca.gov). The Borrower can take no responsibility for the continued accuracy of this internet address or for the accuracy, completeness or timeliness of information posted therein, and such information is not incorporated herein by such reference.

*State Cash Management Legislation.* On March 1, 2010, the Governor signed a bill (and on March 4, 2010, subsequently signed a clean-up bill to clarify certain provisions of such bill) to provide additional cash management flexibility to State fiscal officials (the “Cash Management Bill”). The Cash Management Bill authorized deferral of certain payments during the 2010-11 fiscal year for school districts (not to exceed \$2.5 billion in the aggregate at any one time, and a maximum of three deferrals during the fiscal year). The Cash Management Bill permitted deferrals of payments to K-12 schools in July 2010, October 2010 and March 2011, for not to exceed 60, 90 and 30 days, respectively, but, depending on actual cash flow conditions at the time, and allowed the State Controller, Treasurer and Director of Finance to either accelerate or delay the deferrals up to 30 days or reduce the amounts deferred. The Cash Management Bill also permitted the State to move a deferral to the prior month or to a subsequent month upon 30 days written notice by the State Department of Finance to the Legislative Budget Committee, except that the Cash Management Bill provided that the deferral for March 2011 was required to be paid prior to April 30. The Cash Management Bill provided for exceptions to the deferrals for school districts that could demonstrate hardship. The Cash Management Bill made it necessary for many school districts (and other affected local agencies) to increase the size and/or frequency of their cash flow borrowings during fiscal year 2010-11. Similar legislation was enacted for fiscal year 2011-12 and fiscal year 2013-13. The Borrower is authorized to borrow temporary funds to cover its annual cash flow deficits and, as a result of this or similar future legislation, MERF might find it necessary to utilize cash flow borrowings or increase the size or frequency of its cash flow borrowings in future years. The Borrower cannot predict if additional deferrals will be made in any future fiscal years.

*Future Budgets and Budgetary Actions.* The Borrower and the Authority cannot predict what actions will be taken in the future by the State Legislature and the Governor to address changing State revenues and expenditures or the impact such actions will have on State revenues available in the current or future years for education. The State budget will be affected by national and State economic conditions and other factors which the Borrower and MERF cannot predict and over which they will have no control. Certain actions could result in a significant shortfall of revenue and cash, and could impair the State’s ability to fund schools during the current and in future fiscal years. State budget shortfalls in future fiscal years could have a material adverse financial impact on MERF.

### **Allocation of State Funding to Charter Schools**

Under the Charter School Law, each charter school is calculated to have a “general purpose entitlement,” which is based on the statewide average amount of State aid, local property taxes and other revenue received by school districts of similar type and serving similar pupil populations. The general

purpose entitlement is calculated on a per student basis at each of four grade level ranges and is multiplied by the charter school's ADA in each grade level range.

Each charter school's general purpose entitlement is funded from local funding in lieu of property taxes and, to the extent such funding is insufficient to fulfill the entire entitlement, from money appropriated by the State from the State's general fund for education. The local share, which must be transferred in monthly installments to the charter school by the chartering school district in lieu of property taxes, is the average amount of property taxes per ADA received by the district, including charter school students, multiplied by the charter school's ADA.

In addition, each charter school is entitled to a "categorical block grant." School districts must qualify for categorical aid on the basis of the actual number of students in attendance who qualify for one or more special programs, and may only spend the aid for the restricted purposes of the program. Charter school students do not need to qualify individually for each program of certain categorical aid. Instead, a charter school "categorical block grant" is computed annually. In 2012-13, the amount available to the School was based upon \$412 per ADA plus an allowance for economically impacted students based upon individual school data. Categorical block grant funding may be used for any purpose determined by the charter school. In addition, charter schools may apply for and receive separate categorical funds for many programs that are not included in the block grants, if otherwise eligible, but may not receive aid for programs exclusively or almost exclusively provided by a county office of education.

Starting in fiscal year 2013-14, the revenue limit funding system and most categorical programs funding charter schools was replaced by the "Local Control Funding Formula" (see "—Local Control Funding Formula" above). Among the stated goals of the Local Control Funding Formula funding equity between charter schools and traditional school districts. The Local Control Funding Formula distributes combined resources to school districts through a base revenue limit funding grant ("Base Grant") per unit of ADA with additional supplemental funding allocated to local educational agencies based on their proportion of English language learners and economically disadvantaged students. While most of the funds previously allocated in separate blocks will be swept into the Base Grant, special education, nutrition, after school programming, safety and federal categorical funds will continue to be funded as they have been in previous years. Every school district is entitled to a Base Grant adjusted for grade span cost differentials, multiplied by ADA. The funds received by charter schools will grow with increasing ADA. The average Base Grant, when fully implemented, is expected to be equal to the current average non-deficit school district revenue limit. School districts are entitled to supplemental funding for each high need student of 20% of the Base Grant. When the proportion of English language learners and economically disadvantaged students exceeds 55% of its total student population, a school district is to receive an additional concentration grant equal to 35% of the Base Grant for each additional English language learner and economically disadvantaged student above the 55% threshold. Notably, however, charter schools may not receive a higher percentage of concentration funding than students in the district in which the charter is located. Under the new formula, "basic aid districts" are defined as school districts whose local property taxes equal or exceed their district's formula allocation and would continue to retain local property taxes in excess of their new formula allocation.

The following tables describe ADA-based State funding of California charter school education for Fiscal Year 2010-11 through 2013-14.

**Table 1**  
STATE FUNDING OF CALIFORNIA CHARTER SCHOOL EDUCATION  
FISCAL YEAR 2010-11  
(Dollars per unit of ADA)

|                             | Grades  |         |         |         |
|-----------------------------|---------|---------|---------|---------|
|                             | K-3     | 4-6     | 7-8     | 9-12    |
| General Purpose Block Grant | \$5,077 | \$5,153 | \$5,306 | \$6,158 |
| Categorical Block Grant     | 412     | 412     | 412     | 412     |
| Lottery                     | 133     | 133     | 133     | 133     |
| Total*                      | \$5,622 | \$5,698 | \$5,851 | \$6,693 |

**Table 2**  
STATE FUNDING OF CALIFORNIA CHARTER SCHOOL EDUCATION  
FISCAL YEAR 2011-12  
(Dollars per unit of ADA)

|                             | Grades  |         |         |         |
|-----------------------------|---------|---------|---------|---------|
|                             | K-3     | 4-6     | 7-8     | 9-12    |
| General Purpose Block Grant | \$5,090 | \$5,166 | \$5,319 | \$6,163 |
| Categorical Block Grant     | 398     | 398     | 398     | 398     |
| Lottery                     | 129     | 129     | 129     | 129     |
| Total*                      | \$5,617 | \$5,683 | \$5,846 | \$6,690 |

**Table 3**  
STATE FUNDING OF CALIFORNIA CHARTER SCHOOL EDUCATION  
FISCAL YEAR 2012-13  
(Dollars per unit of ADA)

|                             | Grades  |         |         |         |
|-----------------------------|---------|---------|---------|---------|
|                             | K-3     | 4-6     | 7-8     | 9-12    |
| General Purpose Block Grant | \$5,112 | \$5,193 | \$5,349 | \$6,190 |
| Categorical Block Grant     | 412     | 412     | 412     | 412     |
| Lottery**                   | 150     | 150     | 150     | 150     |
| Total*                      | \$5,674 | \$5,755 | \$5,911 | \$6,752 |

\* Excludes special education, No Child Left Behind, class size reduction, supplemental instruction, economic impact aid, and National School Lunch Program funding and any private philanthropy, grants, or other fund-raising.

\*\* Estimated.

**Table 4**  
STATE FUNDING OF CALIFORNIA CHARTER SCHOOL EDUCATION  
FISCAL YEAR 2013-14  
(Dollars per unit of ADA)

|                        | Grades  |         |         |         |
|------------------------|---------|---------|---------|---------|
|                        | K-3     | 4-6     | 7-8     | 9-12    |
| Target LCFF Base Grant | \$6,952 | \$7,056 | \$7,266 | \$8,149 |
| CTE/CSR Add-ons        | 723     | N/A     | N/A     | 219     |
| Lottery**              | 154     | 154     | 154     | 154     |
| Total*                 | \$7,829 | \$7,210 | \$7,420 | \$8,522 |

\* Excludes special education, nutrition, After School Education and Safety, SB 740, Charter School Facility Grants, No Child Left Behind, class size reduction, supplemental instruction, economic impact aid, and National School Lunch Program funding and any private philanthropy, grants, or other fund-raising.

\*\* Estimated.

Source: California Charter Schools Association; California Department of Education

For a description of the School's revenue sources, see APPENDIX A – "CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION" herein.

## **CONSTITUTIONAL AND STATUTORY PROVISIONS AFFECTING EDUCATION REVENUES AND APPROPRIATIONS**

### **Limitations on Revenues**

*Article XIII A of the California Constitution.* Article XIII A of the State Constitution, adopted and known as Proposition 13, was approved by the voters in June 1978. Section 1(a) of Article XIII A limits the maximum ad valorem tax on real property to one percent of "full cash value," and provides that such tax will be collected by the counties and apportioned according to State law. Section 1(b) of Article XIII A provides that the one-percent limitation does not apply to ad valorem taxes levied to pay interest and redemption charges on: (i) indebtedness approved by the voters prior to July 1, 1978, or (ii) bonded indebtedness for the acquisition or improvement of real property approved on or after July 1, 1978, by two-thirds of the votes cast on the proposition, or (iii) bonded indebtedness incurred by a school district or community college district for the construction, reconstruction, rehabilitation or replacement of school facility or the acquisition or lease of real property for school facility, approved by 55% of the voters of the district, but only if certain accountability measures are included in the bond proposition. Charter schools may not conduct bond elections or issue bonds payable from property taxes, but may benefit from the proceeds of bonds issued by the school district in which the charter school is located.

Section 2 of Article XIII A defines "full cash value" to mean the county assessor's valuation of real property as shown on the Fiscal Year 1975-76 tax bill, or, thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred. The full cash value may be adjusted annually to reflect inflation at a rate not to exceed 2% per year, or to reflect a reduction in the consumer price index or comparable data for the area under taxing jurisdiction, or may be reduced in the event of declining property value caused by substantial damage, destruction or other factors. The Revenue and Taxation Code permits county assessors who have reduced the assessed valuation of a property as a result of natural disasters, economic downturns or other factors, to subsequently "recapture" such value (up to the pre-decline value of the property) at an annual rate higher than 2%, depending on the assessor's measure of the restored value of the damaged property. The California courts have upheld the constitutionality of this procedure. Legislation enacted by the State Legislature to implement Article XIII A provides that, notwithstanding any other law, local agencies may not levy any ad valorem property tax except the 1% base tax levied by each County and taxes to pay debt service on indebtedness approved by the voters as described above.

Since its adoption, Article XIII A has been amended a number of times. These amendments have created a number of exceptions to the requirement that property be reassessed when purchased, newly constructed or a change in ownership has occurred. These exceptions include certain transfers of real property between family members, certain purchases of replacement dwellings for persons over age 55 and by property owners whose original property has been destroyed in a declared disaster, and certain improvements to accommodate disabled persons and for seismic upgrades to property. These amendments have resulted in marginal reductions in the property tax revenues of local school districts.

Both the California State Supreme Court and the United States Supreme Court have upheld the validity of Article XIII A.

Section 51 of the Revenue and Taxation Code permits county assessors who have reduced the assessed valuation of a property as a result of natural disasters, economic downturns or other factors, to

subsequently “recapture” such value (up to the pre-decline value of the property) at an annual rate higher than 2%, depending on the assessor’s measure of the restoration of value of the damaged property. The constitutionality of this procedure was challenged in a lawsuit brought in 2001 in the Orange County Superior Court and in similar lawsuits brought in other counties, on the basis that the decrease in assessed value creates a new “base year value” for purposes of Proposition 13 and that subsequent increases in the assessed value of a property by more than 2% in a single year violate Article XIII A. On appeal, the California Court of Appeal upheld the recapture practice in 2004, and the State Supreme Court declined to review the ruling, leaving the recapture law in place. Charter schools are not directly dependent on local property taxes. To the extent local property taxes fund the general purpose entitlement, losses in local property tax income are required to be made up by the State.

*Proposition 30.* On November 6, 2012, California voters approved Proposition 30 (“Proposition 30”), which temporarily increases the State Sales and Use Tax and personal income tax rates on higher incomes. Proposition 30 temporarily imposes an additional tax on all retailers, at the rate of 1/4% of gross receipts of any retailer from the sale of all tangible personal property sold in the State from June 1, 2014 to December 31, 2017. Proposition 30 also imposes an additional excise tax on the storage, use, or other consumption in the State of tangible personal property purchased from a retailer on and after June 1, 2014, and before January 1, 2017, for storage, use, or other consumption in the State, at the rate of 1/4% of the sales price of the property. For personal income taxes imposed beginning in the taxable year commencing January 1, 2012 and ending January 1, 2019, Proposition 30 increases the marginal personal income tax rate by: (i) 1% for taxable income over \$250,000 but less than \$300,000 (over \$340,000 but less than \$408,000 for joint filers) (ii) 2% for taxable income over \$300,000 but less than \$500,000 (over \$408,000 but less than \$680,000 for joint filers) and (iii) 3% for taxable income over \$500,000 (over \$608,000 for joint filers).

The revenues generated from the temporary tax increases will be included in the calculation of the Proposition 98 minimum funding guarantee for school districts and community college districts. From an accounting perspective, the revenues generated from the temporary tax increases will be deposited into the State account created pursuant to Proposition 30 called the Education Protection Account (the “EPA”). Pursuant to Proposition 30, funds in the EPA will be allocated quarterly, with 89% of such funds provided to schools districts and 11% provided to community college districts. The funds will be distributed to school districts and community college districts in the same manner as existing unrestricted per-student funding, except that no school district will receive less than \$200 per unit of ADA and no community college district will receive less than \$100 per full time equivalent student. The governing board of each school district and community college district is granted sole authority to determine how the moneys received from the EPA are spent, provided that, the appropriate governing board is required to make these spending determinations in open session at a public meeting and such local governing boards are prohibited from using any funds from the EPA for salaries or benefits of administrators or any other administrative costs.

*Future Initiatives.* Articles XIII A, Proposition 98 and Proposition 30 were each adopted as measures that qualified for the ballot pursuant to the State’s initiative process. From time to time, other initiative measures could be adopted, further affecting State and local revenues for education, and the ability or obligation of these government agencies to expend revenues for charter school purposes.

## **RISK FACTORS**

*Investment in the Bonds involves substantial risks. The following information should be considered by prospective investors in evaluating the Bonds. However, the following does not purport to be an exclusive listing of risks and other considerations which may be relevant to investing in the Bonds, and the order in which the following information is presented is not intended to reflect the relative*

*importance of any such risks. Certain factors which could result in a reduction of revenues available to MERF and the School and a corresponding reduction in payments made to the Authority by the Borrower are discussed herein.*

A number of factors could have an adverse impact on the ability of MERF and the School to generate sufficient revenues to meet its obligations under the Lease, which could, in turn, have an effect on the Borrower's ability to make loan repayments. The ability of MERF and the School to generate sufficient revenues is dependent upon a number of elements, including California State budget pressures, demand for charter schools, the ability of MERF and the School to provide the educational services and classes demanded by parents or to attract students generally, changes in the level of confidence in the public school system in general or public charter schools in particular, competition, faculty recruitment, demographic changes, legislation, governmental regulations, changes in immigration policy, litigation and MERF and the School's ability to achieve and maintain enrollment levels. This, in turn, is affected by numerous circumstances both within and outside the control of MERF and the School, including a continuation of favorable governmental policies and programs with respect to public charter schools (see "CHARTER SCHOOLS IN CALIFORNIA" herein); the competitive appeal and perceived quality of the School's curriculum; MERF and/or the School's abilities and those of its faculty and administration; and the benevolence of supporters of MERF and the School. **There can be no assurance given that revenues of the School or of MERF will not decrease. Any and all financial projections are only good faith estimates and are not intended as a representation or warranty as to the future financial condition of MERF or the School. Neither Accord nor the Sole Member is liable on the Lease, the Loan Agreement or the Bonds.**

See APPENDIX A – "CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION" hereto for more detailed information regarding the Borrower, MERF, the School and the Project.

## **General**

The Bonds are payable primarily from Revenues which consists of Rent payments made by MERF under the Lease. The Borrower will be credited with such payments against its obligations under the Loan Agreement. The Borrower has also encumbered the Facility with the Deed of Trust as security for its obligation to make the payments under the Loan Agreement. No representation or assurance can be made that Revenues will be realized by the Borrower in amounts sufficient to make the payments under the Loan Agreement.

THE BONDS DO NOT CONSTITUTE A DEBT OR LIABILITY OF THE STATE OF CALIFORNIA OR OF ANY POLITICAL SUBDIVISION THEREOF, OTHER THAN THE AUTHORITY, BUT SHALL BE PAYABLE SOLELY FROM THE FUNDS PROVIDED THEREFOR. THE AUTHORITY SHALL NOT BE OBLIGATED TO PAY THE PRINCIPAL OF THE BONDS, OR THE REDEMPTION PREMIUM, IF ANY OR INTEREST THEREON, EXCEPT FROM THE FUNDS PROVIDED THEREFOR UNDER THE INDENTURE AND NEITHER THE FAITH AND CREDIT NOR THE TAXING POWER OF THE STATE OF CALIFORNIA OR OF ANY POLITICAL SUBDIVISION THEREOF, INCLUDING THE AUTHORITY, IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF OR THE REDEMPTION PREMIUM, IF ANY OR INTEREST ON THE BONDS. THE ISSUANCE OF THE BONDS SHALL NOT DIRECTLY OR INDIRECTLY OR CONTINGENTLY OBLIGATE THE STATE OF CALIFORNIA OR ANY POLITICAL SUBDIVISION THEREOF TO LEVY OR TO PLEDGE ANY FORM OF TAXATION OR TO MAKE ANY APPROPRIATION FOR THEIR PAYMENT. THE AUTHORITY HAS NO TAXING POWER.



### **School's Reliance on MERF; MERF not Liable on Loan Agreement or Bonds.**

The School was established by and is operated by MERF. The success of MERF and the School in attracting and retaining students, and on managing its expenses, depends largely on the efforts of MERF. MERF is a party to and obligated under the Lease, but is not a party to, or obligated under, the Loan Agreement or the Bonds. See APPENDIX A – “CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION” hereto for more information about MERF. Financial information with respect to the School is included in APPENDIX B hereto.

### **California Budget Deficit**

In recent years the State of California has struggled with large budget deficits, leading to cuts in a number of programs, including K-12 education. See “State Funding of Education” herein. Although the fiscal situation in the State has improved as of late, reductions in State K-12 funding have been significant in recent years and future reductions may occur, reducing State revenues of the School. Such reductions may be material and may adversely affect the ability of MERF to make payments under the Lease.

### **Tax Related Issues**

***Tax-Exempt Status of Interest on the 2014A Bonds.*** The Code imposes a number of requirements that must be satisfied for interest on state and local obligations, such as the Bonds, to be excludable from gross income for federal income tax purposes. These requirements include limitations on the use of Bond proceeds, limitations on the investment of Bond proceeds prior to expenditure, a requirement that certain investment earnings on Bond proceeds be paid periodically to the United States and a requirement that the issuers file an information return with the Internal Revenue Service (the “IRS”). The Authority, MERF, the School, the Borrower and the Sole Member have covenanted in certain of the documents referred to herein that they will comply with such requirements. Failure by any of the foregoing to comply with the requirements stated in the Code and related regulations, rulings and policies may result in the treatment of interest on the 2014A Bonds as taxable, retroactively to the date of issuance of the 2014A Bonds.

***Maintenance of the Tax-Exempt Status.*** The tax exempt status of the Bonds depends upon the maintenance by each of MERF and of the Sole Member of their status as an organization described in section 501(c)(3) of the Code. The maintenance of such status is contingent on compliance with general rules promulgated in the Code and related regulations regarding the organization and operation of tax-exempt entities, including the operation for charitable and educational purposes and avoidance of transactions which may cause the assets of either to inure to the benefit of private individuals.

In recent years, the IRS has increased the frequency and scope of its audit and other enforcement activity regarding tax-exempt organizations and, in particular, charter schools. As a result, tax-exempt organizations are increasingly subject to a greater degree of scrutiny. The primary penalty available to the IRS under the Code with respect to a tax-exempt entity engaged in unlawful private benefit is the revocation of tax-exempt status. Although the IRS has not frequently revoked the 501(c)(3) tax-exempt status of nonprofit corporations, it could do so in the future. Loss of tax-exempt status by MERF or the Sole Member could potentially result in loss of tax exemption of interest on the Bonds and of other existing and future tax-exempt debt of the Borrower, if any, and defaults in covenants regarding the 2014A Bonds and other existing and future tax-exempt debt, if any, would likely be triggered.

Less onerous sanctions have been enacted which focus enforcement on private persons who transact business with a tax-exempt organization rather than the tax-exempt organization, but these sanctions do not replace the other remedies available to the IRS as mentioned above.

***State Income Tax Exemption.*** The loss by MERF or the Sole Member of federal tax exemption might trigger a challenge to its State income tax exemption. Such event could be adverse and material.

***Unrelated Business Income.*** In recent years, the IRS and state, county and local taxing authorities have been undertaking audits and reviews of the operations of tax-exempt organizations with respect to their exempt activities and the generation of unrelated business taxable income (“UBTI”). Neither the Sole Member nor MERF currently report any UBTI. The Sole Member and the School may participate in activities which generate UBTI in the future. If so, the Sole Member and MERF believe they would properly account for and report UBTI; nevertheless, an investigation or audit could lead to a challenge which could result in taxes, interest and penalties with respect to unreported UBTI and in some cases could ultimately affect their tax-exempt status, as well as the exclusion from gross income for federal income tax purposes of the interest on the 2014A Bonds.

***Exemption from Property Taxes.*** In recent years, State, county and local taxing authorities have been undertaking audits and reviews of the operations of tax-exempt corporations with respect to their real property tax exemptions. The Facility is currently exempt from California real property taxation.

***Potential Legislation.*** From time to time, there are Presidential proposals, proposals of various federal committees, and legislative proposals in the Congress and in the states that, if enacted, could alter or amend the federal and state tax matters referred to herein or adversely affect the marketability or market value of the Bonds or otherwise prevent holders of the Bonds from realizing the full benefit of the tax exemption of interest on the 2014A Bonds. Further, such proposals may impact the marketability or market value of the Bonds simply by being proposed. As one example, the Obama Administration’s proposed 2014 budget includes a legislative proposal which, for tax years beginning after December 31, 2014, would limit the exclusion from gross income of interest on obligations like the Bonds to some extent for taxpayers who are individuals and whose income is subject to higher marginal income tax rates. If enacted in its current form, the 2014 budget could adversely impact the marketability and market value of the Bonds and prevent certain Bondholders (depending on the financial and tax circumstances of the particular bondholder) from realizing the full benefit of the tax exemption of interest on the Bonds. It cannot be predicted whether or in what form any such proposal might be enacted or whether if enacted it would apply to bonds issued prior to enactment. In addition, regulatory actions are from time to time announced or proposed and litigation is threatened or commenced which, if implemented or concluded in a particular manner, could adversely affect the market value, marketability or tax status of the 2014A Bonds. It cannot be predicted whether any such regulatory action will be implemented, how any particular litigation or judicial action will be resolved, or whether the Bonds would be impacted thereby.

Purchasers of the Bonds should consult their tax advisors regarding any pending or proposed legislation, regulatory initiatives or litigation. The disclosures and opinions expressed herein are based upon existing legislation and regulations as interpreted by relevant judicial and regulatory authorities as of the date of issuance and delivery of the Bonds, and no opinion is expressed as of any date subsequent thereto or with respect to any proposed or pending legislation, regulatory initiatives or litigation.

### **Factors That Could Affect the Security Interest in the Pledged Revenues**

The Trustee’s security interest in the Facility may be subordinated to the interest and claims of others in several instances. Some examples of cases of subordination of prior claims are (i) statutory liens, (ii) rights arising in favor of the United States of America or any agency thereof, (iii) present or

future prohibitions against assignment in any statutes or regulations, (iv) constructive trusts, equitable liens or other rights impressed or conferred by any state or federal court in the exercise of its equitable jurisdiction, (v) federal or state bankruptcy or insolvency laws that may affect the enforceability of the Loan Agreement or the Lease, (vi) rights of third parties in amounts not in the possession of the Trustee, and (vii) claims that might arise if appropriate financing or continuation statements are not filed in accordance with the California Uniform Commercial Code as from time to time in effect.

### **Limitations On Value of the Facility and to Remedies Under the Deed of Trust**

***Maintenance of Value.*** The Facility is located in a region that has experienced significant real property market volatility over the past several years. There can be no assurance that should the Borrower default in making the payments due under the Loan Agreement, the Facility could be foreclosed upon and sold for the amount owed with respect to the Bonds.

***Appraised Value is only an Estimate.*** The appraisal report (the “Appraisal”) for the Facility estimates the market value of the Facility as of a particular date. No assurance can be given that the Facility could be sold for the amount of estimated market value thereof contained in the Appraisal. Appraisals, including the Appraisal, are subject to numerous limitations.

***Hazardous Substances.*** While governmental taxes, assessments and charges are common claims against the value of property, other less common claims may be relevant. One of the most serious in terms of the potential reduction in the value that may be realized is a claim with regard to hazardous substances. In general, the Borrower may be required by law to remedy conditions of the Facility relating to release of hazardous substances. The federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, sometimes referred to as “CERCLA” or the “Superfund Act,” is the most well-known and widely applicable of these laws. California laws with regard to hazardous substances are stringent and similar to certain federal acts. Under many of these laws, the owner (or operator) is obligated to remedy a hazardous substance condition of property whether or not the owner (or operator) had or has anything to do with the creation or handling of the hazardous substance. The effect, therefore, should the Facility be affected by a hazardous substance, is generally to reduce the marketability and value of the parcel by the cost of remedying the condition. Further, such liabilities may arise not simply from the existence of a hazardous substance but from the method of handling the hazardous substance. Any of these potentialities could significantly affect the value of the Project that would be realized upon a default and foreclosure.

***Foreclosure.*** There are two methods of foreclosing on a deed of trust or mortgage under California law, by nonjudicial sale and by judicial sale. Foreclosure under a deed of trust may be accomplished by a nonjudicial trustee’s sale under the power of sale provision in the deed of trust. Prior to such sale, the trustee must record a notice of default and election to sell and send a copy to the trustor, to any person who has recorded a request for a copy of the notice of default and notice of sale, to any successor in interest of the trustor and to certain other parties discernible from the real property records. The trustee then must wait for the lapse of at least three months after the recording of the notice of default and election to sell before establishing the trustee’s proposed sale date and giving a notice of sale (in a form mandated by California statutes). The notice of sale must be posted in a public place and published once a week for three consecutive calendar weeks, with the first such publication preceding the trustee’s sale by at least 20 days. Such notice of sale must be posted on the property and sent, at least 20 days prior to the trustee’s sale, to the trustor, to each person who has requested a copy, to any successor in interest of the trustor, to the beneficiary of any junior deed of trust and to certain other parties discernible from the real property records. In addition, the notice of sale must be recorded with the county recorder at least 14 days prior to the date of sale. The trustor, any successor in interest of the trustor in the trust property, or any person having a junior lien or encumbrance of record may, during the statutory reinstatement period,

which extends to five days prior to the sale date, cure any monetary default by paying any delinquent installments of the debt then due under the terms of the deed of trust and certain other obligations secured thereby (exclusive of principal due by virtue of acceleration upon default) plus costs and expenses actually incurred in enforcing the obligation and certain statutorily limited attorneys' and trustees' fees. Following a nonjudicial sale, neither the trustor nor any junior lienholder has any right of redemption, and the beneficiary may not ordinarily obtain a deficiency judgment against the trustor.

Should foreclosure under a deed of trust be sought in the form of a judicial foreclosure, it is generally subject to most of the delays and expenses of other lawsuits, and may require several years to complete. The primary advantage of a judicial foreclosure is that the beneficiary is entitled, subject to other limitations, to obtain a deficiency judgment against the trustor to the extent that the amount of the debt is in excess of the fair market value of the property. Following a judicial foreclosure sale, the trustor or its successors in interest may redeem the property for a period of one year (or a period of only three months if the proceeds of sale are sufficient to satisfy the debt, plus interest and costs). In addition, in order to assure collection of any rents assigned as additional collateral under the Deed of Trust, a receiver for the Facility may be appointed by a court.

***Seismic.*** The Facility is located in a seismically active region of California. The occurrence of severe seismic activity could result in substantial damage to the Facility, which could adversely affect the ability of the Borrower to operate the Facility and/or for MERF to make the Lease payments and could adversely affect the value of the Facility.

***Environmental Risks.*** There are potential risks relating to liabilities for environmental hazards with respect to the ownership of any real property. If hazardous substances are found to be located on a property, owners of such property may be held liable for costs and other liabilities related to the removal of such substances which costs and liabilities could exceed the value of the Facility or any portion thereof.

## **Bankruptcy**

The rights and remedies of the owners of the Bonds are subject to various provisions of the Federal Bankruptcy Code (the "Bankruptcy Code"). If the Borrower were to become a debtor in a bankruptcy case, its revenues and certain of its accounts receivable and other property created or otherwise acquired after the filing of such petition and for up to 90 days prior to the filing of such petition may not be subject to the security interest created under the Deed of Trust for the benefit of the owners of the Bonds. The filing would operate as an automatic stay of the commencement or continuation of any judicial or other proceeding against the Borrower, and its property, and as an automatic stay of any act or proceeding to enforce a lien upon or to otherwise exercise control over its property. If the bankruptcy court so ordered, the property of the Borrower, including accounts receivable and proceeds thereof, could be used for the financial rehabilitation of the Borrower despite the security interest of the Trustee therein. While the Bankruptcy Code requires that the interest of the Trustee as lien owner be adequately protected before the collateral may be used by the Borrower, such protection could take the form of a replacement lien on assets of the Borrower acquired or created after the bankruptcy petition is instituted. The rights of the Trustee to enforce liens and security interests against the Borrower's assets could be delayed during the pendency of the rehabilitation proceedings.

The Borrower could file a plan for the reorganization of its debts in any such proceeding which could include provisions modifying or altering the rights of creditors generally, or any class of them, secured or unsecured. The plan, when confirmed by a court, binds all creditors who had notice or knowledge of the plan and discharges all claims against the debtor provided for in the plan. No plan may be confirmed unless certain conditions are met, among which are that the plan is in the best interests of creditors, is feasible and has been accepted by each class of claims impaired thereunder. Each class of

claims has accepted the plan if at least two thirds in dollar amount and more than one half in number of the class cast votes in its favor. Even if the plan is not so accepted, it may be confirmed if the court finds that the plan is fair and equitable with respect to each class of non-accepting creditors impaired thereunder and does not discriminate unfairly.

## **Key Management**

The creation of, and the philosophy of teaching in, charter schools initially may reflect the vision and commitment of a few key persons on the board of directors and/or the upper management of the charter school (“Key Directors/Managers”). Loss of any such Key Directors/Managers, and the inability of charter schools to find comparable qualified replacements, could adversely affect the operations or financial results of such charter schools. See APPENDIX A – “CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION” for more information regarding the governance and management of each of the Borrower and the Sole Member.

## **Factors Associated with MERF and the School’s Operations**

There are a number of factors affecting schools generally that could have an adverse effect on financial position and ability to make Lease payments necessary to make debt service payments on the Bonds. These factors include, but are not limited to, failure to qualify for statutory reimbursement under state programs; increasing costs of compliance with federal, state or local laws or regulations, including, but not limited to, laws or regulations concerning environmental quality, work safety and accommodation of persons with disabilities; taxes or other charges imposed by federal, state or local governments; the ability to attract a sufficient number of students due to reputational concerns; changes in existing statutes pertaining to the powers of MERF or the School and disruption of MERF or the School’s operations by real or perceived threats against MERF or the School, its staff members or students. None of the Borrower, the Sole Member, MERF or the School can assess or predict the ultimate effect of such factors on their operations or financial results or on MERF’s ability to make Lease payments.

## **Inter-Company Transfers**

As described herein, MERF currently operates 10 charter schools in addition to the School, each of which has its own charter. State aid per-pupil payments are received by each charter and held by MERF in separate accounts for each school. In the past, loans have been made from the account of one charter to MERF as well as to the accounts of other charters operated by MERF. Such loans have been evidenced by notes among the parties. The Lease permits such loans between the School and MERF or other MERF charter schools upon certification by MERF that Cash on Hand will not be less than the requirement both prior to and subsequent to the making of such a loan. See “The Lease - Maintenance of Separate Accounts” herein. Although all inter-company loans are subject a variety of restrictions, loans between MERF and other MERF chartered schools are not subject to the restrictions of the Lease.

## **Incurrence of Additional Indebtedness**

The Loan Agreement permits the Borrower to incur additional indebtedness upon compliance with certain restrictions as set forth therein. The incurrence of such additional indebtedness could increase the economic burden on the Borrower and thereby adversely affect the ability of the Borrower to make required payments under the Loan Agreement. In addition, in connection with the incurrence of Additional Indebtedness, the Borrower may secure Additional Indebtedness with a deed of trust on the Facility that would be on parity with the Deed of Trust that secures the Series 2014 Bonds. APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL BOND

DOCUMENTS – THE LOAN AGREEMENT - Additional Covenants and Agreements of Borrower – Limited Purpose of the Borrower; Limitations on Additional Debt; Permitted Liens.”

**Non-Recourse Debt**

The obligations of the Borrower under the Loan Agreement are non-recourse in nature. The Borrower is obligated to meet its obligations under the Loan Agreement except for certain reimbursement and indemnity obligations. Should the Borrower be unable to meet its obligations under the Loan Agreement, the Trustee’s remedies will be limited to foreclosure upon the Deed of Trust and recovery against the funds and accounts held by the Trustee (other than the Rebate Fund) pursuant to the Indenture.

**Other Limitations on Enforceability of Remedies**

There exists common law authority and authority under various state statutes pursuant to which courts may terminate the existence of a nonprofit corporation or undertake supervision of its affairs on various grounds, including a finding that the corporation has insufficient assets to carry out its stated charitable purposes or has taken some action which renders it unable to carry out such purposes. Such court action may arise on the court’s own motion or pursuant to a petition of a state attorney general or other persons who have interests different from those of the general public, pursuant to the common law and statutory power to enforce charitable trusts and to see to the application of their funds to their intended charitable uses.

In addition to the foregoing, the realization of any rights under the Loan Agreement, the Indenture, the Lease and the Deed of Trust upon a default depends upon the exercise of various remedies specified in the Loan Agreement, the Indenture, the Lease and the Deed of Trust. These remedies may require judicial action which is often subject to discretion and delay. Under existing law, certain of the remedies specified in the Loan Agreement, the Indenture, the Lease and the Deed of Trust may not be readily available or may be limited. For example, a court may decide not to order the specific performance of the covenants contained in the Loan Agreement, the Indenture, the Lease and the Deed of Trust. Accordingly, the ability of the Authority or the Trustee to exercise remedies under the Loan Agreement, the Indenture, the Lease and the Deed of Trust upon an Event of Default could be impaired by the need for judicial or regulatory approval.

**Specific Risks of Charter Schools**

***Charter School Law.*** The Charter School Law is evolving. Amendments are made relatively frequently and legislative and public attitudes are still forming. It is likely that additional changes will be made in the future, some of which may be adverse to charter schools in general and to MERF or the School in particular. See “CHARTER SCHOOLS IN CALIFORNIA — Amendments to the Charter School Law” herein.

***Non-Renewal or Revocation of Charters.*** The Charter School Law enables charter authorizers to grant five-year charters which may be renewed after evaluation and can be revoked at any time by the charter granting authority or by the State Board of Education due to educational non-performance, fiscal mismanagement or other factors. See “CHARTER SCHOOLS IN CALIFORNIA” herein. Management of MERF believes that it has stable relationships with the Los Angeles Unified School District, its district charter authorizer, which, under appropriate circumstances is authorized to grant charters under the Charter School Law. See APPENDIX A – “CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION” herein.

***Budgetary Constraints.*** Charter Schools are funded primarily from State and local tax revenues and budgetary pressures at the State or local level may jeopardize future funding levels, which may adversely affect the ability of MERF to make its payments under the Lease. See “STATE FUNDING OF EDUCATION” above.

***Enrollment Levels.*** MERF’s revenues and financial strength will depend in part upon maintaining certain enrollment levels at the School. A reduction in enrollment will have a direct result of reducing ADA payable with respect to the affected charter school.

***Risk of Reduction in ADA Funding.*** Since the vast majority of funds for MERF’s operations, including operations related to the School, come from the State on the basis of ADA, each school is subject to State funding reductions or restrictions that might affect all public school districts and charter schools. Among other such risks, over time the State may not increase ADA-based funding commensurate with increases in the cost of MERF operations, or the State may even decrease ADA-based funding.

ADA-based funding is determined by actual attendance, and not by student enrollment data. Regardless of the statewide level of ADA-based funding, MERF is subject to loss of revenue if enrollment at the School should decrease, or if average daily attendance should decrease even if enrollment remains steady, whether due to student illness, truancy or other factors. Such a loss of revenues could adversely affect the ability of MERF to make its payments under the Lease.

In addition, the Charter School Law prohibits a charter school from imposing fees or charges for its educational services. Therefore, MERF is dependent upon receipt of ADA funding relating to its charter schools, including the School, as well as philanthropic support. There is little any school can do to increase revenues, other than to admit a larger number of students.

## **Claims and Insurance Coverage**

Litigation could arise from the corporate and business activities of the Borrower and of MERF, including from their status as employers. Many of these risks are covered by insurance, but some are not. For example, claims arising from wrongful termination or sexual molestation claims and business disputes may not be covered by insurance or other sources and may, in whole or in part, be a liability of the affected school if determined or settled adversely.

The Borrower covenants and agrees in the Loan Agreement that it will keep maintain, or caused to be maintained, property, general liability and business interruption insurance with respect to the Facility at levels set forth in the Loan Agreement. The Borrower is not obligated by the Loan Agreement to maintain earthquake insurance and there can be no assurance that the Borrower will obtain such coverage in the future. See APPENDIX C – “SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL BOND DOCUMENTS — THE LOAN AGREEMENT” herein.

## **ABSENCE OF MATERIAL LITIGATION**

### **The Authority**

To the knowledge of the Authority, there is no action, suit, proceeding, inquiry or investigation, at law or in equity, before or by any court, governmental agency, public board or body, pending against the Authority seeking to restrain or enjoin the sale or issuance of the Bonds, or in any way contesting or affecting any proceedings of the Authority taken concerning the sale thereof, the pledge or application of any moneys or security provided for the payment of the Bonds, the validity or enforceability of the

documents executed by the Authority in connection with the Bonds, the completeness or accuracy of the Limited Offering Memorandum or the existence or powers of the Authority relating to the sale of the Bonds.

### **The Borrower**

There is no controversy or litigation of any nature now pending against the Borrower or, to the knowledge of the officers of the Borrower, threatened, which seeks to restrain or enjoin the sale or issuance of the Bonds or in any way contests or affects the validity of the Bonds, or any proceedings of the Borrower taken concerning the issuance or sale of the Bonds, or the pledge or application of any moneys or security provided for the payment of the Bonds, the use of the Bond proceeds or the existence or powers of the Borrower relating to the issuance of the Bonds.

### **MERF**

There is no controversy or litigation of any nature now pending against MERF or, to the knowledge of the officers of MERF, threatened, which seeks to restrain or enjoin the sale or issuance of the Bonds or in any way contests or affects the validity of the Bonds, or any proceedings of the School taken concerning the issuance or sale of the Bonds, or the pledge or application of any moneys or security provided for the payment of the Bonds, the use of the Bond proceeds or the existence or powers of MERF relating to the issuance of the Bonds.

## **TAX MATTERS**

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Authority (“Bond Counsel”), based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2014A Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Code and is exempt from State of California personal income taxes. In the further opinion of Bond Counsel, interest on the 2014A Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix F hereto.

To the extent the issue price of any maturity of the Bonds is less than the amount to be paid at maturity of such Bonds (excluding amounts stated to be interest and payable at least annually over the term of such Bonds), the difference constitutes “original issue discount,” the accrual of which, to the extent properly allocable to each Beneficial Owner thereof, is treated as interest on the 2014A Bonds which is excluded from gross income for federal income tax purposes and State of California personal income taxes. For this purpose, the issue price of a particular maturity of the Bonds is the first price at which a substantial amount of such maturity of the Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to any maturity of the Bonds accrues daily over the term to maturity of such Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such Bonds. Beneficial Owners of the Bonds should consult their own tax advisors with respect to the tax consequences of ownership of Bonds with original issue discount, including the treatment of Beneficial Owners who do not purchase such Bonds in the original offering to the public at the first price at which a substantial amount of such Bonds is sold to the public.



Bonds purchased, whether at original issuance or otherwise, for an amount higher than their principal amount payable at maturity (or, in some cases, at their earlier call date) (“Premium Bonds”) will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of bonds, like the Premium Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, the amount of tax-exempt interest received, and a Beneficial Owner’s basis in a Premium Bond, will be reduced by the amount of amortizable bond premium properly allocable to such Beneficial Owner. Beneficial Owners of Premium Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the Bonds. The Authority, the Borrower, the Sole Member and MERF have made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the 2014A Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the 2014A Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the Bonds. The opinion of Bond Counsel assumes the accuracy of these representations and compliance with these covenants. Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken), or events occurring (or not occurring), or any other matters coming to Bond Counsel’s attention after the date of issuance of the Bonds may adversely affect the value of, or the tax status of interest on, the Bonds. Accordingly, the opinion of Bond Counsel is not intended to, and may not, be relied upon in connection with any such actions, events or matters.

In addition, Bond Counsel has relied, among other things, on the opinion of Musick Peeler & Garrett LLP, Counsel to the Borrower, MERF and the Sole Member, regarding the current qualification of MERF and the Sole Member as organizations described in Section 501(c)(3) of the Code. Such opinion is subject to a number of qualifications and limitations. Bond Counsel has also relied upon representations of the Borrower, the School, MERF and the Sole Member concerning their “unrelated trade or business” activities as defined in Section 513(a) of the Code. Neither Bond Counsel nor Counsel to the Borrower, the School, MERF and the Sole Member has given any opinion or assurance concerning Section 513(a) of the Code and neither Bond Counsel nor Counsel to the Borrower, the School, MERF and the Sole Member can give or has given any opinion or assurance about the future activities of the Borrower, the School, MERF or the Sole Member, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the resulting changes in enforcement thereof by the IRS. Failure of MERF and the Sole Member to be organized and operated in accordance with the IRS’s requirements for the maintenance of its status as an organization described in Section 501(c)(3) of the Code, or to operate the facility financed by the Bonds in a manner that is substantially related to their charitable purposes under Section 513(a) of the Code, may result in interest payable with respect to the Bonds being included in federal gross income, possibly from the date of the original issuance of the Bonds.

Although Bond Counsel is of the opinion that interest on the 2014A Bonds is excluded from gross income for federal income tax purposes and is exempt from State of California personal income taxes, the ownership or disposition of, or the amount, accrual or receipt of interest on, the Bonds may otherwise affect a Beneficial Owner’s federal, state or local tax liability. The nature and extent of these other tax consequences depends upon the particular tax status of the Beneficial Owner or the Beneficial Owner’s other items of income or deduction. Bond Counsel expresses no opinion regarding any such other tax consequences.

Current and future legislative proposals, if enacted into law, clarification of the Code or court decisions may cause interest on the Bonds to be subject, directly or indirectly, in whole or in part, to federal income taxation or to be subject to or exempted from state income taxation, or otherwise prevent Beneficial Owners of the Bonds from realizing the full current benefit of the tax status of such interest. For example, Representative Dave Camp, Chair of the House Ways and Means Committee released draft legislation that would subject interest on the 2014A Bonds to a federal income tax at an effective rate of 10% or more for individuals, trusts, and estates in the highest tax bracket, and the Obama Administration proposed legislation that would limit the exclusion from gross income of interest on the Bonds to some extent for high-income individuals. The introduction or enactment of any such legislative proposals or clarification of the Code or court decisions may also affect, perhaps significantly, the market price for, or marketability of, the Bonds. Prospective purchasers of the Bonds should consult their own tax advisors regarding the potential impact of any pending or proposed federal or state tax legislation, regulations or litigation, as to which Bond Counsel is expected to express no opinion.

The opinion of Bond Counsel is based on current legal authority, covers certain matters not directly addressed by such authorities, and represents Bond Counsel's judgment as to the proper treatment of the Bonds for federal income tax purposes. It is not binding on the IRS or the courts. Furthermore, Bond Counsel cannot give and has not given any opinion or assurance about the future activities of the Authority, the Borrower, the School or MERF, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the enforcement thereof by the IRS. The Authority, the Borrower, the School and MERF have covenanted, however, to comply with the requirements of the Code.

Bond Counsel's engagement with respect to the Bonds ends with the issuance of the Bonds, and, unless separately engaged, Bond Counsel is not obligated to defend the Authority, the Borrower, the School, MERF or the Beneficial Owners regarding the tax-exempt status of the Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the Authority, the Borrower and their appointed counsel, including the Beneficial Owners, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds is difficult, obtaining an independent review of the IRS's positions with which the Authority or the Borrower legitimately disagrees may not be practicable. Any action of the IRS, including but not limited to selection of the Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues may affect the market price for, or the marketability of, the Bonds, and may cause the Authority, the Borrower, the Sole Member, Accord or the Beneficial Owners to incur significant expense.

### **Federally Taxable Bonds**

The following discussion summarizes certain U.S. federal tax considerations generally applicable to holders of the Taxable Bonds that acquire their Taxable Bonds in the initial offering. The discussion below is based upon laws, regulations, rulings, and decisions in effect and available on the date hereof, all of which are subject to change, possibly with retroactive effect. Prospective investors should note that no rulings have been or are expected to be sought from the IRS with respect to any of the U.S. federal income tax consequences discussed below, and no assurance can be given that the IRS will not take contrary positions. Further, the following discussion does not deal with all U.S. federal income tax consequences applicable to any given investor, nor does it address the U.S. federal income tax considerations applicable to categories of investors some of which may be subject to special taxing rules (regardless of whether or not such persons constitute U.S. Holders), such as certain U.S. expatriates, banks, REITs, RICs, insurance companies, tax-exempt organizations, dealers or traders in securities or currencies, partnerships, S corporations, estates and trusts, investors that hold their Taxable Bonds as part of a hedge, straddle or an integrated or conversion transaction, or investors whose "functional currency"

is not the U.S. dollar. Furthermore, it does not address (i) alternative minimum tax consequences or (ii) the indirect effects on persons who hold equity interests in a holder. In addition, this summary generally is limited to investors that acquire their Taxable Bonds pursuant to this offering for the issue price that is applicable to such Taxable Bonds (*i.e.*, the price at which a substantial amount of the Taxable Bonds are sold to the public) and who will hold their Taxable Bonds as “capital assets” within the meaning of Section 1221 of the Code.

As used herein, “U.S. Holder” means a beneficial owner of a Taxable Bond that for U.S. federal income tax purposes is an individual citizen or resident of the United States, a corporation or other entity taxable as a corporation created or organized in or under the laws of the United States or any state thereof (including the District of Columbia), an estate the income of which is subject to U.S. federal income taxation regardless of its source or a trust where a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons (as defined in the Code) have the authority to control all substantial decisions of the trust (or a trust that has made a valid election under U.S. Treasury Regulations to be treated as a domestic trust). As used herein, “Non-U.S. Holder” generally means a beneficial owner of a Taxable Bond (other than a partnership) that is not a U.S. Holder. If a partnership holds Taxable Bonds, the tax treatment of such partnership or a partner in such partnership generally will depend upon the status of the partner and upon the activities of the partnership. Partnerships holding Taxable Bonds, and partners in such partnerships, should consult their own tax advisors regarding the tax consequences of an investment in the Taxable Bonds (including their status as U.S. Holders or Non-U.S. Holders).

#### ***For U.S. Holders***

In the opinion of Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions and assuming compliance with certain covenants, interest on the Taxable Bonds is exempt from State of California personal income taxes. Interest on the Taxable Bonds is not excluded from gross income for federal income tax purposes under Section 103 of the Code. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or amount, accrual or receipt of interest on, the Taxable Bonds.

The Taxable Bonds are not expected to be treated as issued with original issue discount (“OID”) for U.S. federal income tax purposes because the stated redemption price at maturity of the Taxable Bonds is not expected to exceed their issue price, or because any such excess is expected to only be a *de minimis* amount (as determined for purposes of the Code).

Prospective investors that are not individuals or regular C corporations who are U.S. persons purchasing the Taxable Bonds for investment should consult their own tax advisors as to any tax consequences to them from the purchase, ownership and disposition of the Taxable Bonds.

***Disposition of the Taxable Bonds.*** Unless a nonrecognition provision of the Code applies, the sale, exchange, redemption, defeasance, retirement (including pursuant to an offer by the Authority) or other disposition of a Taxable Bond, will be a taxable event for U.S. federal income tax purposes. In such event, in general, a U.S. Holder of a Taxable Bond will recognize gain or loss equal to the difference between (i) the amount of cash plus the fair market value of property received (except to the extent attributable to accrued but unpaid interest on the Taxable Bond which will be taxed in the manner described above) and (ii) the U.S. Holder’s adjusted tax basis in the Taxable Bond (generally, the purchase price paid by the U.S. Holder for the Taxable Bond). Any such gain or loss generally will be capital gain or loss. In the case of a noncorporate U.S. Holder of the Taxable Bonds, the maximum marginal U.S. federal income tax rate applicable to any such gain will be lower than the maximum

marginal U.S. federal income tax rate applicable to ordinary income if such U.S. holder's holding period for the Taxable Bonds exceeds one year. The deductibility of capital losses is subject to limitations.

***Tax on Net Investment Income.*** For tax years beginning after December 31, 2012, certain non-corporate U.S. Holders of Taxable Bonds will be subject to a 3.8% tax on the lesser of (1) the U.S. Holder's "net investment income" (in the case of individuals) or "undistributed net investment income" (in the case of estates and certain trusts) for the relevant taxable year and (2) the excess of the U.S. Holder's "modified adjusted gross income" (in the case of individuals) or "adjusted gross income" (in the case of estates and certain trusts) for the taxable year over a certain threshold (which in the case of individuals will be between \$125,000 and \$250,000, depending on the individual's circumstances). A U.S. Holder's calculation of net investment income generally will include its interest income on the Taxable Bonds and its net gains from the disposition of the Taxable Bonds, unless such interest income or net gains are derived in the ordinary course of the conduct of a trade or business (other than a trade or business that consists of certain passive or trading activities). If you are a U.S. Holder that is an individual, estate or trust, you are urged to consult your tax advisors regarding the applicability of this tax to your income and gains in respect of your investment in the Taxable Bonds.

***Information Reporting and Backup Withholding.*** Payments on the Taxable Bonds generally will be subject to U.S. information reporting and "backup withholding." Under Section 3406 of the Code and applicable U.S. Treasury Regulations issued thereunder, a non-corporate U.S. Holder of the Taxable Bonds may be subject to backup withholding at the current rate of 28% with respect to "reportable payments," which include interest paid on the Taxable Bonds and the gross proceeds of a sale, exchange, redemption, retirement or other disposition of the Taxable Bonds. The payor will be required to deduct and withhold the prescribed amounts if (i) the payee fails to furnish a U.S. taxpayer identification number ("TIN") to the payor in the manner required, (ii) the IRS notifies the payor that the TIN furnished by the payee is incorrect, (iii) there has been a "notified payee underreporting" described in Section 3406(c) of the Code or (iv) there has been a failure of the payee to certify under penalty of perjury that the payee is not subject to withholding under Section 3406(a)(1)(C) of the Code. Amounts withheld under the backup withholding rules may be refunded or credited against the U.S. Holder's federal income tax liability, if any, provided that the required information is timely furnished to the IRS.

### ***For Non-U.S. Holders***

***Interest.*** Subject to the discussions below under the headings "Information Reporting and Backup Withholding" and "FATCA," payments of principal of, and interest on, any Taxable Bond to a Non-U.S. Holder, other than (1) a controlled foreign corporation, as such term is defined in the Code, which is related to the Authority through stock ownership and (2) a bank which acquires such Taxable Bond in consideration of an extension of credit made pursuant to a loan agreement entered into in the ordinary course of business, will not be subject to any U.S. withholding tax provided that the beneficial owner of the Taxable Bond provides a certification completed in compliance with applicable statutory and regulatory requirements, which requirements are discussed below under the heading "Information Reporting and Backup Withholding," or an exemption is otherwise established.

***Disposition of the Taxable Bonds.*** Subject to the discussions below under the headings "Information Reporting and Backup Withholding" and "FATCA," any gain realized by a Non-U.S. Holder upon the sale, exchange, redemption, retirement (including pursuant to an offer by the Authority) or other disposition of a Taxable Bond generally will not be subject to U.S. federal income tax, unless (i) such gain is effectively connected with the conduct by such Non-U.S. Holder of a trade or business within the United States; or (ii) in the case of any gain realized by an individual Non-U.S. Holder, such holder is present in the United States for 183 days or more in the taxable year of such sale, exchange, redemption,

retirement (including pursuant to an offer by the Authority) or other disposition and certain other conditions are met.

*U.S. Federal Estate Tax.* A Taxable Bond that is held by an individual who at the time of death is not a citizen or resident of the United States will not be subject to U.S. federal estate tax as a result of such individual's death, provided that at the time of such individual's death, payments of interest with respect to such Taxable Bond would not have been effectively connected with the conduct by such individual of a trade or business within the United States.

*Information Reporting and Backup Withholding.* Subject to the discussion below under the heading "FATCA," current U.S. Treasury Regulations, payment of principal and interest on any Taxable Bonds to a holder that is not a United States person will not be subject to any backup withholding tax requirements if the beneficial owner of the Taxable Bond or a financial institution holding the Taxable Bond on behalf of the beneficial owner in the ordinary course of its trade or business provides an appropriate certification to the payor and the payor does not have actual knowledge that the certification is false. If a beneficial owner provides the certification, the certification must give the name and address of such owner, state that such owner is not a United States person, or, in the case of an individual, that such owner is neither a citizen nor a resident of the United States, and the owner must sign the certificate under penalties of perjury. If a financial institution, other than a financial institution that is a qualified intermediary, provides the certification, the certification must state that the financial institution has received from the beneficial owner the certification set forth in the preceding sentence, set forth the information contained in such certification, and include a copy of such certification, and an authorized representative of the financial institution must sign the certificate under penalties of perjury. A financial institution generally will not be required to furnish to the IRS the names of the beneficial owners of the Taxable Bonds that are not United States persons and copies of such owners' certifications where the financial institution is a qualified intermediary that has entered into a withholding agreement with the IRS pursuant to applicable U.S. Treasury Regulations.

In the case of payments to a foreign partnership, foreign simple trust or foreign grantor trust, other than payments to a foreign partnership, foreign simple trust or foreign grantor trust that qualifies as a withholding foreign partnership or a withholding foreign trust within the meaning of applicable U.S. Treasury Regulations and payments to a foreign partnership, foreign simple trust or foreign grantor trust that are effectively connected with the conduct of a trade or business within the United States, the partners of the foreign partnership, the beneficiaries of the foreign simple trust or the persons treated as the owners of the foreign grantor trust, as the case may be, will be required to provide the certification discussed above in order to establish an exemption from withholding and backup withholding tax requirements. The current backup withholding tax rate is 28% (subject to future adjustment).

In addition, if the foreign office of a foreign "broker," as defined in applicable U.S. Treasury Regulations pays the proceeds of the sale of a Taxable Bond to the seller of the Taxable Bond, backup withholding and information reporting requirements will not apply to such payments provided that such broker derives less than 50% of its gross income for certain specified periods from the conduct of a trade or business within the United States, is not a controlled foreign corporation, as such term is defined in the Code, and is not a foreign partnership (1) one or more of the partners of which, at any time during its tax year, are U.S. persons (as defined in U.S. Treasury Regulations Section 1.1441-1(c)(2)) or (2) which, at any time during its tax year, is engaged in the conduct of a trade or business within the United States. Moreover, the payment by a foreign office of other brokers of the proceeds of the sale of a Taxable Bond, will not be subject to backup withholding unless the payer has actual knowledge that the payee is a U.S. person. Principal and interest so paid by the U.S. office of a custodian, nominee or agent, or the payment by the U.S. office of a broker of the proceeds of a sale of a Taxable Bond, is subject to backup withholding requirements unless the beneficial owner provides the nominee, custodian, agent or broker

with an appropriate certification as to its non-U.S. status under penalties of perjury or otherwise establishes an exemption.

*FATCA.* Sections 1471 through 1474 of the Code, impose a 30% withholding tax on certain types of payments made to foreign financial institutions, unless the foreign financial institution enters into an agreement with the U.S. Treasury to, among other things, undertake to identify accounts held by certain U.S. persons or U.S.-owned entities, annually report certain information about such accounts, and withhold 30% on payments to account holders whose actions prevent it from complying with these and other reporting requirements, or unless the foreign financial institution is otherwise exempt from those requirements. In addition, FATCA imposes a 30% withholding tax on the same types of payments to a non-financial foreign entity unless the entity certifies that it does not have any substantial U.S. owners or the entity furnishes identifying information regarding each substantial U.S. owner. Failure to comply with the additional certification, information reporting and other specified requirements imposed under FATCA could result in the 30% withholding tax being imposed on payments of U.S. source interest (including OID) and sales proceeds of debt obligations held by or through a foreign entity. Withholding under FATCA generally will apply to (i) payments of U.S. source interest (including OID) made after June 30, 2014, (ii) gross proceeds from the sale, exchange or retirement of debt obligations paid after December 31, 2016 and (iii) certain foreign “pass-thru” payments no earlier than January 1, 2017, but exempt from withholding any payments made on and proceeds realized from the disposition of obligations that are outstanding on July 1, 2014 and are not substantially modified after that date, which exemption should exclude the Taxable Bonds from the withholding provisions of FATCA. Prospective investors should nonetheless consult their own tax advisors regarding FATCA and its effect on them.

### ***Circular 230***

Under 31 C.F.R. part 10, the regulations governing practice before the IRS (Circular 230), the Authority, the Borrower, the Sole Member and MERF and their respective tax advisors are (or may be) required to inform prospective investors that:

- Any advice contained herein is not intended or written to be used, and cannot be used, by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer;
- Any such advice is written to support the promotion or marketing of the Bonds and the transactions described herein; and
- Each taxpayer should seek advice based on the taxpayer’s particular circumstances from an independent tax advisor.

### **APPROVAL OF LEGALITY**

The validity of the Bonds and certain other legal matters are subject to the approving opinion of Orrick, Herrington & Sutcliffe LLP, San Francisco, California, Bond Counsel to the Authority. A complete copy of the proposed form of Bond Counsel opinion is contained in Exhibit F hereto. Certain matters will be passed upon for the Authority by its special counsel, Nixon Peabody LLP, for the Borrower, the Sole Member and MERF by Musick Peeler & Garrett LLP, Los Angeles, California, and for the Underwriter by Eichner Norris & Neumann PLLC, Washington, District of Columbia. Bond Counsel undertakes no responsibility for the accuracy, completeness or fairness of this Limited Offering Memorandum. Orrick, Herrington & Sutcliffe LLP, as Disclosure Counsel, will provide certain other legal services for the Authority.

## **RATING**

Standard & Poor's Rating Services, a Division of The McGraw Hill Companies (the "Rating Agency") has assigned the Bonds a rating of "BB." Such rating reflects only the view of the Rating Agency at the time such rating was issued, and neither the Authority nor the Borrower makes any representation as to the appropriateness of the rating. Any explanation of the significance of such rating may be obtained from the Rating Agency at 55 Water Street, New York, New York 10041. The School furnished to the Rating Agency information and materials about the School and relating to the Bonds, certain of which information and materials have not been included herein. Generally, rating agencies base their ratings on such information and materials and on investigations, studies and assumptions by the rating agencies. The rating is not a recommendation to buy, hold or sell the Bonds. There is no assurance that such rating will continue for any given period of time or that such rating will not be revised downward or withdrawn entirely by the Rating Agency if, in its judgment, circumstances so warrant. Any such downward revision or withdrawal of the rating can be expected to have an adverse effect on the market price of the Bonds. The Borrower and MERF will undertake to file notice of any formal change in any rating that relates to the Bonds that could affect the value of the Bonds. See APPENDIX D – "FORM OF CONTINUING DISCLOSURE AGREEMENT."

## **CONTINUING DISCLOSURE**

The Borrower and MERF will execute and deliver a Continuing Disclosure Agreement pursuant to which each will, for the benefit of the Beneficial Owners of the Bonds, annually compile and deliver to the Trustee certain financial information and operating data relating to the operations of the Borrower and MERF, and provide notices of the occurrence of certain enumerated events, if material. The form of the Continuing Disclosure Agreement is attached hereto as Appendix D. These covenants have been made in order to assist the Underwriter in complying with Securities and Exchange Commission Rule 15c2-12(b)(5) (the "Rule"). The Borrower and MERF have not previously entered into any undertakings under the Rule.

## **FINANCIAL ADVISOR**

The Borrower has retained Urban Futures, Incorporated, Orange, California, as Financial Advisor (the "Financial Advisor") for the sale of the Bonds. The Financial Advisor is not obligated to undertake, and has not undertaken to make, an independent verification or to assume any responsibility for the accuracy, completeness of the information contained in this Limited Offering Memorandum.

## **UNDERWRITING**

The Bonds are being purchased by RBC Capital Markets, LLC (the "Underwriter"). The Underwriter has agreed to purchase the 2014A Bonds at a price of \$5,609,652.50 (being the principal amount of the Bonds, less an Underwriter's discount of \$65,347.50), and to purchase the 2014B Bonds at a price of \$289,947.50 (being the principal amount of the Bonds, less an Underwriter's discount of \$55,052.50). The Bond Purchase Agreement ("Bond Purchase Agreement") pursuant to which the Bonds are being purchased by the Underwriter provides that the Underwriter will purchase all of the Bonds if any are purchased. The obligation of the Underwriter to make such purchase is subject to certain terms and conditions set forth in the Bond Purchase Agreement. The Underwriter may offer and sell the Bonds to certain dealers and others at prices different from the prices stated on the inside cover page of this Limited Offering Memorandum. The offering prices may be changed from time to time by the Underwriter.

## **FINANCIAL STATEMENTS**

The audited financial statements of Magnolia Educational & Research Foundation and the School, respectively, for the fiscal year ended June 30, 2013, included in this Official Statement as Appendix B, have been audited by Hill, Morgan & Associates, LLP, independent certified public accountants (the “Auditor”), to the extent and for the periods indicated in their respective reports thereon. The Auditor has neither been requested to review this Official Statement, nor requested to consent to the inclusion of such reports herein. The unaudited financial statements of the School and of Magnolia Educational & Research Foundation for the period from July 1, 2013 through March 31, 2014 are also included in Appendix B. The Borrower will represent in the Loan Agreement that, since June 30, 2013, there has been no material adverse change in the financial condition or results of operations of the Borrower or the Lessee.

## **MISCELLANEOUS**

The foregoing and subsequent summaries and descriptions of provisions of the Bonds and the Indenture and all references to other materials not purporting to be quoted in full are only brief outlines of some of the provisions thereof and do not purport to summarize or describe all of the provisions thereof, and reference is made to said documents for full and complete statements of their provisions. The appendices attached hereto are a part of this Limited Offering Memorandum. Copies, in reasonable quantity, of the Indenture, Loan Agreement and the Lease may be obtained during the offering period upon request directed to the Underwriter.

NONE OF THE INFORMATION IN THIS LIMITED OFFERING MEMORANDUM HAS BEEN SUPPLIED OR VERIFIED BY THE AUTHORITY OTHER THAN, THE INFORMATION UNDER THE CAPTIONS “THE AUTHORITY” AND “ABSENCE OF MATERIAL LITIGATION — THE AUTHORITY.” THE AUTHORITY MAKES NO REPRESENTATION OR WARRANTY, EXPRESSED OR IMPLIED, AS TO (1) THE ACCURACY OR COMPLETENESS OF INFORMATION IN THIS LIMITED OFFERING MEMORANDUM OTHER THAN IN THE SECTIONS IDENTIFIED ABOVE; (2) THE VALIDITY OF THE BONDS; OR (3) THE TAX STATUS OF THE INTEREST ON THE BONDS.

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The distribution and use of this Limited Offering Memorandum has been approved by the Authority, the Borrower and MERF.

**MPM Sherman Way LLC,**  
a California limited liability company

By: **MAGNOLIA PROPERTIES MANAGEMENT,  
INC.,** its Sole Member

By: /s/ Mekan Muhammedov  
Authorized Representative

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## **APPENDIX A**

### **CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION**

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## **APPENDIX A**

### **CERTAIN INFORMATION ABOUT THE BORROWER, THE SCHOOL, THE PROJECT AND MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION**

*The information in this Appendix A has been compiled from information provided by representatives of Magnolia Educational & Research Foundation, and has not been independently confirmed or verified by either the Underwriter, Financial Advisor or the Issuer. Capitalized terms used but not separately defined herein shall have the meanings given thereto in this Official Statement, including Appendix C – “SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL BOND DOCUMENTS.”*

#### **INTRODUCTION**

MPM Sherman Way LLC (the “Borrower”), is a California limited liability company whose sole member is Magnolia Properties Management, Inc. (“MPM” or the “Sole Member”). At the request of the Borrower, the Authority is issuing the Bonds for the purpose of making a loan to the Borrower, pursuant to the Loan Agreement. Pursuant to the Loan Agreement, the Borrower will use the loan of the proceeds, along with other available funds of the Borrower, to finance the acquisition, improvement and equipping of the land and facilities located at 18238 Sherman Way, Reseda, CA 91335 (as more fully described herein, the “Facility”), to be owned by the Borrower and leased to Magnolia Educational & Research Foundation, a California nonprofit public benefit corporation, also known as Magnolia Public Schools (“MERF”), for use and occupancy by Magnolia Science Academy 1, also known as Magnolia Science Academy (the “School”). Proceeds of the 2013 Bonds and other funds will also be used to fund a reserve fund and make an initial deposit into the Reserve and Replacement Fund, as well as to pay costs of issuance of the Bonds. The School currently operates at the site of the Facility pursuant to a lease with the Seller.

#### **The Borrower**

The Borrower is a single purpose entity formed for the sole purpose of acquiring and owning the Facility. The Borrower has no significant assets other than the Facility and is not expected to accumulate any. It also has no operating experience. Therefore, no financial information regarding the Borrower is provided in this Official Statement.

#### **The Sole Member**

Magnolia Properties Management, Inc., a California nonprofit public benefit corporation (the “Sole Member”) is the sole member of the Borrower. The Sole Member was formed in 2012 and in the same year received a determination letter from the Internal Revenue Service recognizing it as exempt from taxation under Section 501(a) of the Internal Revenue Code of 1986 (the “Code”) as an organization described in Section 501(c)(3) of the Code. The Sole Member provides property development and maintenance services for schools operated by MERF and was formed as a supporting organization for MERF. The Sole Member is not obligated under the Loan Agreement and therefore no financial information regarding the Sole Member is provided in this Official Statement.

The Sole Member is governed by a three-member board of directors. All staff of the Sole Member are employees of MERF. See “MAGNOLIA PROPERTIES MANAGEMENT, INC.” below.

### **The Charter Management Organization**

MERF operates 11 charter schools (the “Magnolia Schools”) located in California. While each school has its own charter, MERF operates all the Magnolia Schools as a single California nonprofit corporation, and all faculty and staff of the Magnolia Schools are employees of MERF.

MERF was incorporated on August 28, 1997 as an organization described under section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the “Code”).

## **THE PROJECT**

### **General**

The Project consists of the acquisition and remodeling of the School’s existing site and facilities, located at 18238 Sherman Way, Reseda, California 91335. A portion of the proceeds of the Bonds will be used to finance the acquisition and improvement of the Facility, as follows:

|               |                       |
|---------------|-----------------------|
| Acquisition   | \$4,500,000.00        |
| Improvements  | <u>\$1,000,000.00</u> |
| <b>Total:</b> | <b>\$5,500,000.00</b> |

The Facility was originally leased by MERF and converted for use as charter school in 2002. The Borrower will acquire the Facility with proceeds of the Bonds and will lease it to MERF to operate and manage the Facility for use and occupancy by the School pursuant to the Lease. See “SECURITY AND SOURCES OF PAYMENT FOR THE BONDS – The Lease” in the Limited Offering Memorandum.

The 26,950 square foot Facility was originally built in 1955 and provides capacity to serve a total of approximately 500 students. The Facility currently includes six administrative offices, twenty classrooms, one computer laboratory and two science laboratories. The planned improvements to the Facility include creating a new main office area, creation of additional classroom space, addition of a shade structure, planter boxes and seating in the lunch area, installation of interior and exterior windows, an additional bathroom, stair railings, lighting and flooring, as well as new furnishings, signage and an entry canopy. An additional science laboratory will also be added as part of the renovations.

### **Appraisal**

According to a December 12, 2012 appraisal of the Facility, the “as-is” market value of the property is \$4,500,000. Copies of such appraisal can be obtained from the Underwriter by contacting: RBC Capital Markets, 2398 East Camelback Road, Ste. 700, Phoenix AZ 85016.

## **Environmental Assessments**

The Borrower obtained a Phase I Environmental Site Assessment for the Facility, dated November 5, 2013, prepared by Centec Engineering, La Crescenta, California. This assessment did not reveal evidence of any “recognized environmental condition” associated with the current or former use of the property.

### **MAGNOLIA PROPERTIES MANAGEMENT, INC.**

The Sole Member was formed in 2012 as a California nonprofit public benefit corporation to support MERF, and is the sole member of the Borrower. Sole Member’s mission is to own, operate, and maintain, either directly or as the sole member of a California limited liability company, real estate for use as charter schools. Such facilities are then leased to the various schools operated by Magnolia Public Schools.

The Board of Directors of MPM currently consists of three members, as follows:

*Ismail Hakki Karaman – President and Director.* (Current Term: July 2013 to July 2018) Mr. Karaman has served as Chief Operations Officer of MERF since 2013. Mr. Karaman has been in the education field over 20 years, as an administrator in Europe, Africa, Washington, D.C., New York and California. Mr. Karaman joined MERF in 2008 as a Principal of Magnolia Science Academy-3 and later served as Principal of Magnolia Science Academy-San Diego from 2011-2013. Mr. 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.

*Mekan Muhammedov – Treasurer and Director.* (Current Term: February 2012 to February 2017) Mr. Muhammedov, who, in addition to being a director, serves as Treasurer of MPM, obtained his Bachelor of Arts degree in Political Science at California State University, Northridge. Currently, Mr. Muhammedov holds a Master of Arts degree in Political Science from California State University Northridge. Mr. Muhammedov joined MERF in 2005 and became Business Manager at the School in 2006 and at Magnolia Science Academy 2 in 2009. In 2010, Mr. Muhammedov was promoted to Director of Finance at MERF. In June 2011, Mr. Muhammedov became Chief Financial Officer of MERF.

*Melik Sayin – Secretary and Director.* (Current Term: February 2012 to February 2017) Mr. Sayin, who, in addition to being a director, serves as Secretary of MPM, obtained his Bachelor of Science degree in Physics Engineering. He has worked as an IT manager and network administrator for five years. He has also taught computer science, math, physics, and chemistry at the middle and high school levels.

### **MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION**

MERF is a non-profit charter management organization headquartered in Westminster, California, that operates a network of charter schools throughout California, including the School. MERF is dedicated to inspiring students to choose career paths in science, technology, engineering and math (“STEM”), while providing a robust, standards-based education program within a supportive culture that strives toward excellence. MERF’s “culture of excellence” is based on core values, the cultivation of college aspirations, and a dedicated, highly trained

faculty that implements a comprehensive educational approach. Its four-part educational model includes (1) technology integration across all subject areas, (2) advanced studies for selected students, (3) proactive and personalized academic guidance, and (4) data-driven instruction based on analysis of student performance, all in support of a standards-based educational program.

In 1998, MERF began its first project of providing volunteer tutors for middle and high school students, especially for math, science and computer technology assistance, utilizing its connections to major research universities throughout southern California. In 1999, MERF organized and implemented a joint program with the Culver City Unified School District to provide tutoring for district students. It also started a free tutoring program in the Sherman Oaks/Van Nuys Area of the San Fernando Valley. These programs resulted from cooperative partnerships with school districts to support educational initiatives. Then, in the fall of 2002, MERF established its first charter school, the School, in the San Fernando Valley. Since then, MERF has grown in size and sophistication, establishing ten other charter schools in California, while maintaining the goal of providing an innovative, high-quality education to students. See Table A-1 for information about the locations and charter renewal status of the existing schools.

MERF's central office (the "central office") executes the decisions and policies set by the Board of Directors of MERF (the "Board") and manages business operations in MERF's schools. The responsibilities of the central office include overseeing operations for compliance with charter agreements, hiring school principals, managing payroll, purchasing, budgeting and auditing, community outreach, public relations, data management, information technology and facilities, and serving as a point of contact for the chartering agency. MERF employs 284 teachers, administrators and staff. Sixteen of the 284 employees are staff of MERF assigned to the central office, with the remainder being staff and faculty assigned to the Magnolia Schools. All staff and faculty of the School, as well as those of the other Magnolia Schools, are employees of MERF.

### **Board of Directors and Senior Staff**

The Board of MERF currently consists of six members. The Board establishes broad policies to implement the mission of MERF, including the School. The policies adopted by the Board influence school operations such as educational program development, after-school programs, financial planning, staffing, benefits, compensation, and conditions for student suspension or expulsion.



The current members of the Board and their current terms are as follows:

| <b>Name</b>                  | <b>Position</b> | <b>Beginning<br/>of Current<br/>Term</b> | <b>End of<br/>Current<br/>Term</b> |
|------------------------------|-----------------|--|------------------------------------|
| Umit Yapanel                 | President       | 10/12/2012                               | 10/11/2017                         |
| Saken Sherkhanov             | Secretary       | 11/13/2013                               | 11/12/2018                         |
| Bayram Yenikaya              | Director        | 11/19/2009                               | 11/18/2014                         |
| Mustafa Kaynak               | Director        | 11/19/2009                               | 11/18/2014                         |
| Francisco Huidobro           | Director        | 10/12/2012                               | 10/11/2017                         |
| Noel Russell-<br>Unterburger | Director        | 10/12/2012                               | 10/11/2017                         |

Brief biographical information about the members of the Board follows below.

*Umit Yapanel, Ph.D. – President and Director.* Dr. Yapanel is a director and serves as President of MERF. Dr. Yapanel is a Senior Algorithm Developer for Automatic Speech Recognition (ASR) Audience, Inc. During the spring of 2010, he served as an adjunct faculty at the University of Colorado at Boulder, Department of Electrical, Computer and Energy Engineering and taught Digital Signal Processing classes to graduate and undergraduate students. Previously, Dr. Yapanel worked as a Speech Technology Engineer at a high-tech company focused on inventing language monitoring systems for children and on early detection of delay and deficiencies related to infants' language development, and spent two summers at IBM's TJ Watson Research Center in New York. Dr. Yapanel holds a Bachelor of Science in Electronics and Communications, a Master of Science in Communications Engineering and a Master of Science in Electrical and Computer Engineering, as well as a degree in Automatic Speech Recognition from the University of Colorado at Boulder. From 2003-2007, Dr. Yapanel served as a founding board member at Lotus School for Excellence, a charter school in Aurora, Colorado.

*Saken Sherkhanov – Secretary and Director.* Mr. Sherkhanov is a director and serves as Secretary of MERF. Mr. Sherkhanov received his Bachelor of Science degree in biology from California Institute of Technology in 2003. Upon completion of his undergraduate study, he joined the School as a physical science and biology teacher. During his five-year tenure at the School, he helped to develop the curriculum and adaptive assessment programs for the Physical and Life Sciences courses, introduced advanced math, science and engineering programs, and initiated an Advancement Placement program in multiple schools. Currently, Mr. Sherkhanov is attending a Ph. D. program at UCLA Chemistry & Biochemistry Department.

*Bayram Yenikaya, Ph.D. – Director.* Dr. Yenikaya received his Bachelor of Science degree from Bilkent University in Mathematics and his Ph.D. degree in Applied Mathematics from the University of Minnesota. Since July 2007 Mr. Yenikaya has been a senior member of the consulting staff at Cadence Design Systems, in San Jose, California and previously worked at Invarium, Inc. as an algorithm engineer. He has also been cited for excellence in teaching at University of Minnesota. Mr. Yenikaya has been a member of the development team for Magnolia Science Academy in Santa Clara. Mr. Yenikaya received a silver medal in the

International Math Olympiads in Canada in 1995, and trained Zarathustra Brady, a student at Magnolia Science Academy who received a gold medal in the 2006 International Math Olympiads.

*Mustafa Kaynak, Ph.D. – Director.* Dr. Kaynak received his B.S. degree from Middle East Technical University in 1999, a Master of Engineering degree from National University of Singapore in 2002 and a Ph.D. degree from Arizona State University in 2005, all in electrical engineering. Since November 2005, he has been a member of the technical staff in San Diego, California, data storage division of STMicroelectronics. During his Ph.D. study, Dr. Kaynak's academic research included digital communications, wireless and mobile communications, error correction coding, coding for recording and wireless communication channels.

*Francisco Huidobro – Director.* Mr. Huidobro received his Bachelor of Science degree in Physics and Mathematics in 1986 in Puebla, Mexico from public University of Puebla (BUAP) and finished all taught courses for a Master of Science degree in Astrophysics in 1995 from National Institute of Astrophysics, Optics and Electronics (INAOE) in Mexico. He taught in high schools for about 10 years and in universities for five years. He has worked for the private sector in database and software development, both in Mexico and in Los Angeles, California.

*Noel Russel-Uterburger – Director.* Ms. Russel-Uterburger is an executive-level accounting professional with over 18 years of financial management, leadership and advisory experience and expertise. Her responsibilities include oversight of accounting and finance operations, best practices, ongoing cash flow and budgeting, and financial planning and analysis. In addition to accounting and finance oversight, Ms. Russel-Uterburger offers comprehensive management, internal control and strategic advice to executive management. She has previously held various positions in the nonprofit sector, including as chief financial officer, comptroller and management accounting, served as an accounting director in manufacturing and served as a senior financial analyst in banking. Ms. Russel-Uterburger serves as the financial advisor on the board of directors for the Powell Academy, which is currently seeking charter status, and Dr. Theodore T. Alexander, Jr. Science Center, a charter school within the Los Angeles Unified School District. Ms. Russel-Uterburger holds as an Associate degree in Accounting from Santa Monica College and a Bachelor of Science degree in Business Management from Pepperdine University, Graziadio School of Business & Management.

Key management of MERF are as follows:

*Mehmet Argin – Chief Executive Officer* – Dr. Mehmet Argin has been serving as the Chief Executive Officer of Magnolia Public Schools since July 2012. Prior to joining to Magnolia, he led many charter schools as Chief Executive Officer and school principal at Sonoran Schools, a charter management organization, located in Arizona. Dr. Argin also started the first charter school on US Air-force Installation in 2009. His expertise is in start-up charter schools, organization management, school finance and STEM education. Dr. Argin holds a Ph.D. degree in Electrical Engineering from Arizona State University and has many academic publications in his field.

*Mekan Muhammedov – Chief Financial Officer* – Mr. Muhammedov received his undergraduate degree in Political Science at California State University, Northridge. Currently, Mr. Muhammedov holds a Master’s Degree in Political Science from California State University Northridge. Mr. Muhammedov joined MERF in 2005 and became Business Manager at the School in 2006 and at Magnolia Science Academy 2 in 2009. In 2010, Mr. Muhammedov was promoted to Director of Finance at MERF. In June 2011, Mr. Muhammedov became Chief Financial Officer of MERF. He also serves as Treasurer of the Sole Member.

*Ismail Hakki Karaman – Chief Operating Officer* – Mr. Karaman received his Bachelor of Science degree in Economics and Master of Education degree in School Administration. Mr. Karaman has been in the field of education over twenty years as an Administrator in Europe, Africa, Washington DC, New York and California. Mr. Karaman joined Magnolia Public Schools in 2008 as a Principal of Magnolia Science Academy-3 and then principal of Magnolia Science Academy- San Diego between 2011-2013. In 2013, Mr. Karaman was promoted to Chief Operating Officer at MERF.

*David Yilmaz – Chief Academic Officer* – Mr. Yilmaz pursued his undergraduate study in the Electrical & Electronics Engineering Department at Bilkent University, Turkey, and graduated with high honors. He received his M.S. degree from the Univ. of California, Irvine (UCI), where he worked as a research and teaching assistant in the Electrical & Computer Engineering Dept. He has published journal articles and conference papers in the areas of image processing and circuit simulation, and has developed mathematical software modules for Cadence, a world-known electronic circuit design and simulation company. Mr. Yilmaz has taught computer programming classes to undergraduates at UCI, Microsoft Office applications for the City of Fountain Valley as a volunteer, and SAT Math classes at private organizations. In order to contribute to the field of STEM education in California, he decided to teach math/science/computer classes at Magnolia Science Academy charter school (campus of Magnolia Public Schools in Los Angeles. Holding clear teaching credential in both math and science fields, Mr. Yilmaz served as a teacher, dean of academics, and principal at three different campuses of Magnolia Public Schools for 10 years. Mr. Yilmaz now serves as the Chief Academic Officer coordinating curriculum and instruction, charter renewal, accreditation, and other accountability measures at MPS.

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## Locations, Charter Renewal and Academic Performance

Details of the eleven Magnolia Schools established by MERF in California are as follows:

**Table A-1**  
**MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION**  
**CURRENT SCHOOLS**

| School  | Location  | Year<br>Opened | Charter<br>Renewals    | API 2013   |
|---|---|----------------|------------------------|------------|
| <b>Magnolia Science Academy 1, also known<br/>as Magnolia Science Academy</b> | <b>18238 Sherman Way<br/>Reseda, CA 91335</b>   | <b>2002</b>    | <b>2007 &amp; 2012</b> | <b>797</b> |
| Magnolia Science Academy San Diego  | 6365 Lake Atlin Ave<br>San Diego, CA 92119      | 2005           | 2008                   | 847        |
| Magnolia Science Academy-2, Valley  | 17125 Victory Blvd<br>Van Nuys, CA 91406        | 2007           | 2012                   | 756        |
| Magnolia Science Academy-3, Carson  | 1254 East Helmick Street<br>Carson, CA 90746    | 2008           | 2012                   | 749        |
| Magnolia Science Academy-4, Venice  | 11330 W Graham Place<br>Los Angeles, CA 90064   | 2008           | 2013                   | 761        |
| Magnolia Science Academy-5, Hollywood   | 929 N Las Palmas Ave<br>Los Angeles, CA 9003    | 2008           | 2013                   | 759        |
| Magnolia Science Academy-6, Palms   | 3754 Dunn Dr.<br>Los Angeles CA 90034           | 2009           | 2014                   | 828        |
| Pacific Technology School-Santa Ana   | 102 Baker St E<br>Costa Mesa, CA 92626          | 2009           | 2014                   | 850        |
| Magnolia Science Academy-7, Van Nuys  | 18355 Roscoe Boulevard,<br>Northridge, CA 91325 | 2010           | 2015                   | 904        |
| Magnolia Science Academy-8, Bell  | 6411 Orchard Ave<br>Bell, CA 90201              | 2010           | 2015                   | 763        |
| Magnolia Science Academy Santa Clara  | 2720 Sonoma Place<br>Santa Clara, CA 95051      | 2010           | 2013                   | 904        |

*Source: Magnolia Educational & Research Foundation.*

**Table A-2**  
**MAGNOLIA EDUCATIONAL & RESEARCH FOUNDATION**  
**HISTORIC ENROLLMENT GROWTH**

| <b>Year</b> | <b>Number of Schools</b> | <b>Enrollment</b> |
|-------------|--------------------------|-------------------|
| 2003-04     | 1                        | 191               |
| 2004-05     | 1                        | 225               |
| 2005-06     | 1                        | 375               |
| 2006-07     | 2                        | 490               |
| 2007-08     | 2                        | 695               |
| 2008-09     | 3                        | 1203              |
| 2009-10     | 6                        | 1649              |
| 2010-11     | 9                        | 2595              |
| 2011-12     | 12                       | 3164              |
| 2012-13     | 11 <sup>*</sup>          | 3645              |
| 2013-14     | 11                       | 3935              |

*Source:* Magnolia Educational & Research Foundation.

\* Pacific Technology School (“PTS”), located in Orangevale, California, was closed in 2012 as a result of the inability of MERF to locate adequate facilities, including a Proposition 39 site.

## **THE SCHOOL**

### **Background**

The School was established by MERF in the fall of 2002 as its first charter school, serving grades 6-12. Since opening, the School has been in continuous operation at its current location. The charter for the School was originally approved by the Los Angeles Unified School District in 2002, and has been renewed twice, in 2007 and 2012. The current charter expires June 30, 2017.

The School’s curriculum specifically emphasizes science, technology, engineering and math education while also providing solid instruction in humanities and social sciences, and is in alignment with California Content Standards. The School is fully accredited through the Western Association of Schools and Colleges (“WASC”) and courses offered are transferable to other public schools and meet the entrance requirements of the University of California system and the University of Southern California.

### **Student Enrollment Retention, Wait List and Demographics**

For the 2013-2014 school year, the School student count was 500 students in grades six through twelve. The table below provides an overview of the historic, current and projected enrollment each year by grade level. The School’s authorizer has limited its enrollment to a maximum of 525 students.

**Table A-3**  
**The School's Historical, Current & Projected Enrollment By Grade**

| <b>Grade</b> | <b>School Year</b> |                |                |                |                |                |                |                 |                 |
|--------------|--------------------|----------------|----------------|----------------|----------------|----------------|----------------|-----------------|-----------------|
|              | <b>2007-08</b>     | <b>2008-09</b> | <b>2009-10</b> | <b>2010-11</b> | <b>2011-12</b> | <b>2012-13</b> | <b>2013-14</b> | <b>2014-15*</b> | <b>2015-16*</b> |
| 6            | 91                 | 92             | 109            | 96             | 106            | 83             | 90             | 90              | 90              |
| 7            | 93                 | 94             | 93             | 104            | 94             | 87             | 80             | 80              | 80              |
| 8            | 73                 | 76             | 81             | 88             | 92             | 78             | 80             | 80              | 80              |
| 9            | 48                 | 50             | 59             | 64             | 69             | 70             | 70             | 70              | 70              |
| 10           | 50                 | 39             | 52             | 55             | 63             | 61             | 70             | 70              | 70              |
| 11           | 24                 | 44             | 41             | 44             | 53             | 53             | 55             | 55              | 55              |
| 12           | <u>20</u>          | <u>23</u>      | <u>42</u>      | <u>40</u>      | <u>39</u>      | <u>51</u>      | <u>55</u>      | <u>55</u>       | <u>55</u>       |
| <b>Total</b> | <b>399</b>         | <b>418</b>     | <b>477</b>     | <b>491</b>     | <b>516</b>     | <b>483</b>     | <b>500</b>     | <b>500</b>      | <b>500</b>      |

*Source:* Magnolia Public Schools.

\* Projected.

## Waiting List

There were 328 students on the waiting list for the 2013-14 school year. The largest concentration of students on the waiting list is in the 6<sup>th</sup> grade, for which there were 156 students waiting. The table below sets forth the distribution by grade of students on the waiting list.

**Table A-4**  
**The School's 2013-14 Waiting List By Grade**

| <b>Grade Level</b> | <b>6<sup>th</sup></b> | <b>7<sup>th</sup></b> | <b>8<sup>th</sup></b> | <b>9<sup>th</sup></b> | <b>10<sup>th</sup></b> | <b>11<sup>th</sup></b> | <b>12<sup>th</sup></b> | <b>Total</b> |
|--------------------|-----------------------|-----------------------|-----------------------|-----------------------|------------------------|------------------------|------------------------|--------------|
| Waiting List       | 156                   | 83                    | 29                    | 34                    | 13                     | 8                      | 5                      | 328          |

*Source:* Magnolia Public Schools.

## School Demographics

The demographic profile of the School's students for the 2013-2014 school year is shown below.

**Table A-5**  
**PROFILE OF SCHOOL'S CURRENT STUDENTS**  
**(2013-2014 School Year)**

| <b>Category</b>                     | <b>Percentage of Total Enrollment</b> |
|-------------------------------------|---------------------------------------|
| American Indian or Alaska Native    | 0.8%                                  |
| Asian                               | 4.4%                                  |
| Black or African American           | 1.0%                                  |
| Filipino                            | 5.0%                                  |
| Hispanic or Latino                  | 74.5%                                 |
| Native Hawaiian or Pacific Islander | 0.0%                                  |
| White                               | 14.4%                                 |
| <u>Two or More Races</u>            | <u>0.0%</u>                           |
| Total                               | 100.0%                                |
| Socioeconomically Disadvantaged     | <u>90.0%</u>                          |
| English Learners                    | <u>56.4%</u>                          |
| Students with Disabilities          | <u>11.7%</u>                          |

*Source:* Magnolia Public Schools.

## Retention Rate

Of the non-graduating students enrolled during the 2011-12 school year, approximately 90% of those students returned to the School for the 2012-13 school year and 91% of those students enrolled in the School for the 2013-14 school year.

## Academic Performance Indicators

**General.** In 2012-2013 California used the California Standards Tests (CSTs) to test students in English language arts in grades 2 through 11; math in grades 2 through 7; science in grades 5, 8 and 10; and history-social science in grades 8 and 11. Middle and high school students also took subject-specific CSTs in math and science, depending on the course in which they were enrolled. The CSTs are standards-based tests, which means they measure how well students are mastering specific skills defined for each grade by the State of California. The goal is for all students to score at or above proficient on the tests.

The Academic Performance Index (“API”) is a single number assigned to each school by the California Department of Education to measure overall school performance and improvement over time on statewide testing. The API ranges between 200 and 1,000, with 800 as the statewide goal for all schools. The State Board of Education set the statewide API target at 800 out of a possible score of 1,000, and schools with scores lower than 800 are generally required to meet specified growth targets. In connection with the implementation of Common Core, the State Board of Education suspended the use of API for two years. It is expected that a new formulation of the API will resume during the 2015-16 school year.

**The School.** The School has increased its API score by an overall total of 173 points over the past nine years, surpassing the Los Angeles Unified School District (“LAUSD”) and the California averages in its second year of operation. The School increased its API score by a total of 173 points over the past nine years, surpassing the LAUSD and the California averages in its second year of operation. The table below shows that the School has distinguished itself with its higher API as compared to the Similar Schools API Median specified by LAUSD.

**Table A-6**  
**AVERAGE ACADEMIC PERFORMANCE INDEX (API) OF THE SCHOOL, DISTRICT**  
**SCHOOLS AND STATE SCHOOLS**  
**(Fiscal Years 2008-09 to 2012-13 )**

| <b>Fiscal<br/>Year</b> | <b>API – MSA-1</b> | <b>API<br/>District Schools</b> | <b>API<br/>All State Schools</b> |
|------------------------|--------------------|---------------------------------|----------------------------------|
| 2008-09                | 788                | 693                             | 754                              |
| 2009-10                | 800                | 709                             | 767                              |
| 2010-11                | 807                | 729                             | 778                              |
| 2011-12                | 805                | 744                             | 788                              |
| 2012-13                | 797                | 749                             | 790                              |

*Source:* Magnolia Public Schools.

## Competing Schools

There are a number of traditional public and charter schools at the middle and high school levels located in close proximity to the School, as set forth in the table and map below.



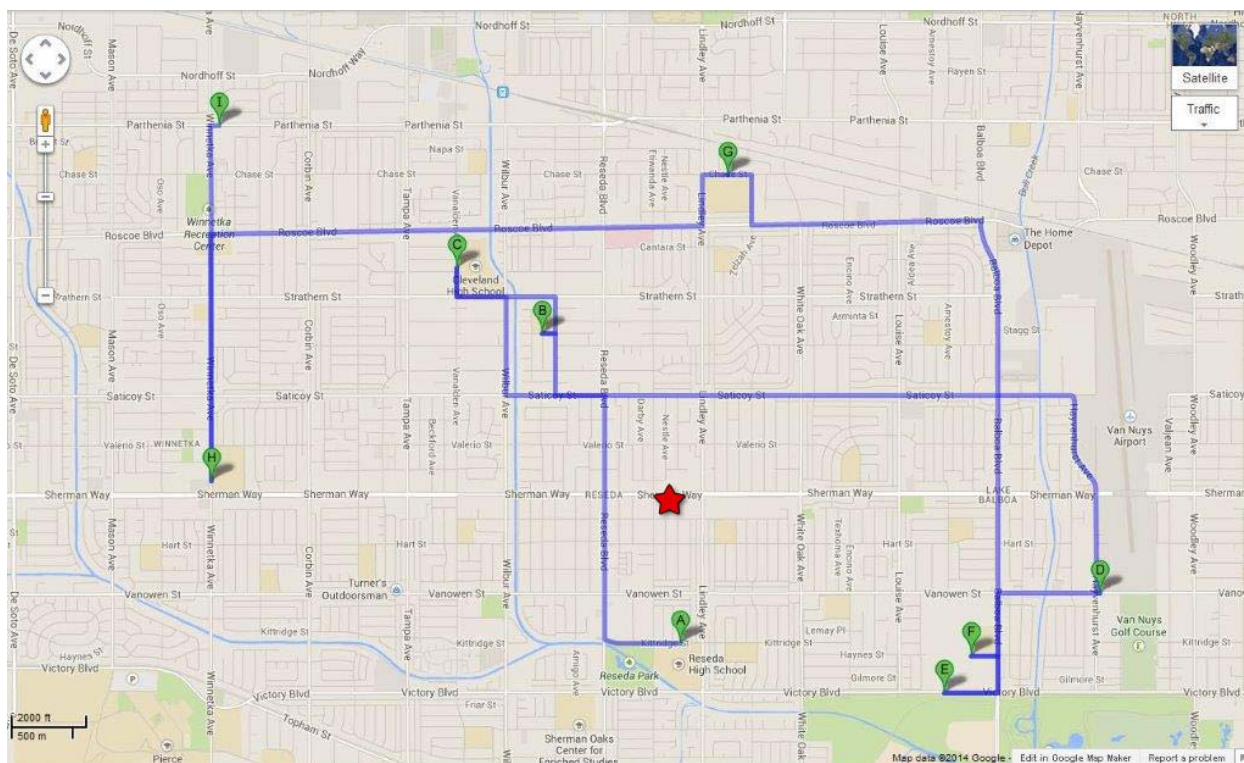
**Table A-7**  
**COMPETING SCHOOLS IN A THREE-MILE RADIUS FROM THE FACILITY**  
**(School Year 2012-13)**

| <u>School</u>                    | <u>Address</u>                          | <u>Enrollment</u> | <u>API</u> |
|----------------------------------|---|-------------------|------------|
| Reseda Senior High School        | 18230 Kittridge St, Reseda CA 91335     | 1,850             | 748        |
| John R. Wooden High School       | 18741 Elkwood Street, Reseda CA 91335   | 139               | 533        |
| Grover Cleveland High School     | 8140 Vanalden Avenue, Reseda CA 9133    | 3,393             | 808        |
| William Mulholland Middle School | 117120 Vanowen St, Van Nuys CA 91406    | 1,473             | 716        |
| High Tech Los Angeles School     | 17111 Victory Blvd. Van Nuys, CA 91406  | 354               | 865        |
| Birmingham Community Charter HS  | 17000 Haynes St. Van Nuys, CA 91406     | 2,923             | 734        |
| Northridge Middle School         | 17960 Chase St, Northridge CA 91325     | 849               | 744        |
| John A. Sutter Middle School     | 7330 Winnetka Ave, Canoga Park CA 91306 | 1,297             | 764        |
| James Jordan Middle School       | 20040 Parthenia St, Northridge CA 91324 | 266               | 792        |

*Source:* Magnolia Public Schools.

The locations of these schools are shown in the map on the following page.

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**Map Legend:** (Star) Magnolia Science Academy-1 (A) Reseda Senior High School; (B) John R. Wooden High School (C) Cleveland High School; (D) William Mulholland Middle School; (E) High Tech Los Angeles; (F) Birmingham Community Charter High School; (G) Northridge Middle School; (H) John A. Sutter Middle School; (I) James Jordan Middle School.

### Statewide Rank and Similar Schools Rank

For the 2012-13 school year, the School had a statewide rank of eight out of ten. A school's statewide rank compares that school to other schools of the same school type in the entire state. On the Base API reports, schools are ranked in ten categories of equal size, called deciles, from one (lowest) to ten (highest).

In addition to statewide ranks, schools are ranked compared to 100 other schools with similar demographic characteristics, educational challenges, and opportunities. For the similar schools rank, schools are ranked into deciles according to school type: elementary, middle, and high. To determine the similar schools rank for a school, a comparison group of 100 similar schools of the same school type is formed for that school, based on similar demographic characteristics. The APIs for this group of 100 schools are ranked into ten categories of equal size, called deciles, from one (lowest) to ten (highest). The School had a similar schools rank of ten out of ten.

## Awards and Recognition

In 2013, the School ranked fifth in California and 48th among 1900 public high schools nationwide by the Washington Post's High School Challenge Index. The School was also

awarded a Gold medal and ranked #30 out of over 2039 schools in California by U.S. News and World Report. This is the third year in a row that the School has received a Gold medal from U.S. News and World Report. Individually, the School's students have won more than 80 awards in nationwide math and science competitions, and science fairs such as the USA Computer Olympiad, American Computer Science League, American Mathematics Competitions, and those held by the Los Angeles County Science Fair and the San Diego County Science Fair. A list of additional accomplishments of the school is listed below by the year in which the award was received.

- 2012: The School was awarded a Gold Medal and ranked #45 out of over 2,000 schools in California by U.S. News and World Report.
- 2011: The School was ranked 13<sup>th</sup> in California and 114<sup>th</sup> nationally by the Washington Post's High School Challenge Index in 2011.
- 2009: The School was awarded the Silver Medal in 2009 by U.S. News & World Report in its ranking of "America's Best High Schools." The School's Future City Competition project, "Megalos" was one of the most exciting designs at the national finals in Washington D.C. Among 35,651 Future City competitors nationwide, the students were selected to be in the top 100.
- 2008: The School was awarded the Bronze Medal in 2008 by U.S. News & World Report in its ranking of "America's Best High Schools."
- 2007: The School received the Title I Academic Achievement Award.
- 2006: The School was selected for the University of Southern California's Compendium of Promising Practices by its School of Education. Zarathustra Brady, an 11th grader at the School, won the gold medal at the 2006 International Mathematical Olympiad, the most prestigious and challenging international math competition for high school students. A Magnolia Science Academy student became the first charter school student to qualify for the U.S. National Math Team. The Los Angeles Unified School District Board of Education presented a letter of recognition to Zarathustra, the first southern Californian to win in a decade.
- 2005: The School was selected as a highly improving charter school by Pacific Research Institute. In 2005, the School's students participated in the 55<sup>th</sup> Los Angeles County Science Fair with 16 projects, which constituted more than 10% of the total projects (142) from LAUSD. The School received the highest number of awards at this fair (two gold medals, one silver medal, and three honorable mentions among 733 participants in 30 categories).
- 2004: The School was selected as a case study for the LAUSD study of charter school innovative and promising practices. The School was the first school in California to participate in the American Computer Science League, in which students from 200 schools throughout the U.S. compete in computer programming. It

was the region winner of the junior division in 2004 among all schools participating from Texas, New Mexico and California.

## Teachers and Staff

The table below summarizes the School's faculty.

**Table A-8**  
**MAGNOLIA SCIENCE ACADEMY 1**  
**TEACHER TRAINING AND EXPERIENCE AT THE SCHOOL**

| Category                                | Number    |
|---|-----------|
| Teachers                                |           |
| Teachers with B.S. or B.A.              | 20        |
| Teachers with a Master's degree         | <u>10</u> |
| Total Teachers                          | 30        |
| Non-Teaching Employees                  | <u>12</u> |
| Total Employees                         | 42        |
| <i>2013-14 Teacher Retention Rate</i>   | 89%       |
| <i>2013-14 Student to Teacher Ratio</i> | 16.66:1   |

*Source:* Magnolia Public Schools.

Salaries are generally equivalent to the salaries paid by District schools. In addition to competitive salaries, MERF offers 100% health, dental and vision care to all full time employees and their dependents.

## Accreditation and California Content Standards

The School's curriculum is in alignment with California Content Standards. The School is fully accredited through the WASC. The courses offered are transferable to other public schools and meet the entrance requirements of the UC and USC systems. The School proactively informs parents on the transferability of courses and the UC/USC requirements by using the school newspaper, school website, parent conferences and the student handbook.

## Academic Mission

The heart of the mission of the School is to provide a solid academic foundation in the core subject areas through implementation of a rigorous, yet motivating and exciting curriculum. The School seeks to:

- Enable students to become self-motivated, competent, and lifelong learners.
- Provide challenging and engaging curriculum with carefully selected standards-based teaching materials and state-of-the-art equipment implemented by highly qualified teachers.

- Create a supportive and caring environment with small class sizes and strong student-parent-teacher communication.
- Improve students' knowledge and skills in core subjects, thereby increasing their chances of success in higher education and beyond.
- Establish intensive enrichment programs for both high and low achieving students.
- Enable students to think objectively and critically, respect truth, and be socially responsible.
- Prepare students to be conscientious and productive citizens.
- Prepare them to become responsible, educated citizens who have the skills and understanding to participate and work productively in a diverse, multicultural community.
- Enable literacy in math, science, and technology, self-motivated life-long learners equipped with communication and presentation skills indispensable for the technologically oriented global environment of the 21st century.
- Provide a standards-based curriculum with emphasis on math, science, and technology, supported by state-of-the-art science and computer labs.
- Provide academic and recreational after-school activities with the aim of enabling students to attain a healthy body, a healthy mind and the disciplinary and behavioral standards necessary for their future endeavors.
- Provide opportunities for parental involvement.

## **Curriculum and Instruction**

### General

The School's educational program specifically emphasizes science, technology, engineering and math (STEM) education. While the curriculum concentrates on STEM, it also provides a solid instruction in humanities and social sciences in order to provide a comprehensive education. At the core of the curriculum is the notion that writing serves as an important vehicle for learning in all subject areas. Thus, at the School, students in all classes write frequently about what they have learned, thereby reinforcing learning and enhancing understanding. Another significant feature of the curriculum is the emphasis on collaborative learning.

- *Math.* Math courses provide a comprehensive scope and sequence in an effort to address the diverse skills, interests and backgrounds of all learners. Students are assessed for their current knowledge and skill level and placed in an appropriate class. Those with little math background in mathematics are supported with remediation and intervention. Students with a strong background are provided with enrichment opportunities. These students also have the opportunity to participate in the Advanced Math and Science Program (AMSP) which challenges qualifying students by preparing them for various levels of competitions from regional to state to international in math, science, and computers. Students can further reinforce the material they learned in math through Technology Integrated Education (TIE) courses.

- *Science.* The science curriculum immerses students in the scientific method and encourages them to use applicable technology, to plan and organize projects, hypothesize, analyze data, and draw conclusions from tests they create. Using this method, MERF believes, will give its students, who accumulate experience applying scientific inquiry and reasoning to real-world problems in the classroom a clear advantage when they are exposed as adults to questions requiring a similar thought and reasoning process. In keeping with the math, science and technology emphasis at the School, advanced courses are offered to spur interest and prepare students for STEM-related fields. Science classes employ technology in laboratory explorations and experimentation. Computer simulations assist in expanding the number of lab opportunities in all grade levels.
- *Language Arts.* The language arts curriculum is literature-based with fluency practice in reading and writing. Conventions of writing are emphasized in daily written homework and lab assignments. The curriculum incorporates a period of sustained silent reading as part of the daily curriculum. Accelerated Reader by Renaissance Learning is used to make essential reading practice more effective for every student and personalize reading practice to each student's current level.
- *Social Science.* The social science courses use inquiry-based research topics involving real-world problems, with a focus on local current events, history and culture. In accord with the National Council for the Social Studies, the School's social studies programs prepare students to identify, understand, and work to solve the challenges facing the nation in an increasingly interdependent world. Education for citizenship is intended to help students acquire and learn to use certain skills, knowledge, and attitudes to prepare them to be competent and responsible citizens throughout their lives, to aim to participate in their communities, be involved politically, and exhibit moral and civic virtues.
- *Art, Music and Technology.* The arts are an important part of the curriculum. Specialized art, music and technology courses will be offered for students at both the middle and high school levels. Study of the arts will be enhanced by their integration into lesson plans in other subjects, such as: The Physics of Sound and Music, The Art of Fractals and Snowflakes, Design Elements in Art (analysis of Marc Chagall's work in technology courses), Design on the Frontier (simulated quilt construction in an eighth grade American History course), Japanese Papermaking and Kite Design (World History and Cultures), and streamline and deco design, as used in automobile styling, and film robots described in science fiction literature (as part of the technology and robotics lab). The School's goal is to immerse its students in culture and diversity through daily discussion, projects and guest speaker presentation.

#### Middle School Curriculum.

Middle school students are required to take core courses in mathematics, science, English-language arts and history-social science. In addition, students are required to take courses in computers and technology, Technology Integrated Education (TIE), physical education, visual and performing arts, foreign languages, sustained silent reading and Get Ready For Life (GRFL).

This program contains units on Life Skills, Study Skills, Test Taking Skills, Drug Prevention, Environmental Issues, Career Awareness, and Character Development. Each middle grade student attends a GRFL class for one period each week. GRFL themes are integrated into broader school-wide activities including assemblies, field trips, displays, announcements, and the general curriculum. Parents are informed about the topic of the week to cultivate their involvement and support at home.

High School Curriculum. One of the cornerstones of the School's academic vision is the understanding that science is a central factor in understanding the world around us. As a college-preparatory school, the School must consider the various factors that correlate with student success at university, such as high school achievement in advanced science and math courses and writing ability. Consequently, the School's curriculum emphasizes writing in all classes, including math and science.

The School's high school curriculum meets all California state minimum course requirements for high school graduation, and the a-g requirements of the University of California system. The School offers courses in mathematics, science, history-social science, and English-language arts. In addition to these core subjects, students are required to take physical education and foreign language courses. Students who wish to apply for higher education at any college or university are required to take two courses in computers and technology, at least one course in the visual and performing arts, and college preparatory electives.

- *Life Skills.* High school students will be required to take a life skills course which consists of a community service project and soft skills development. Students engage in community service to develop and demonstrate the incorporation of necessary life skills into their academic achievements. Students are required to complete at least one community service project before graduation. Projects are curriculum-related and designed to ensure that students gain "real life" responsibility, caring and respect for the community. Students are required to present the results of their community service projects to parents, teachers, students and other members of the School community.
- *Advanced Math and Science Program (AMSP).* AMSP is a program for academically high-achieving students. The School prepares participating students to participate in competitions such as the Intel Science Talent Search, the California State Science Fair, and the International Academic Olympiads in Mathematics, Informatics, Physics and Biology.
- *Technology Integrated Education (TIE).* Use of multimedia and other technology resources in all classes enable powerful learning situations that aid students in extracting meaning out of complexity. Technology Integrated Education (TIE) is a unique program to MERF and integrates math, science, social science and language arts classes with technology education in an engaging and comprehensive manner. Students gain an understanding of how computers operate and learn basic skills to successfully use programs such as Microsoft Word, Excel and PowerPoint. They learn how to design websites and effectively use the Internet. Core teachers spend time each week in the computer lab with their students, using the NetSupport School

Classroom Management program to enhance the interaction between the students and the teachers.

- *AP Courses.* The School is committed to increasing the college readiness of its students by offering Advanced Placement (AP) courses. These courses have been approved by The National Advanced Placement Program by The College Board, based on the quality of the college-preparatory, honors curriculum. Some of the AP courses offered include Biology, Calculus AB, Psychology, Spanish Language, English Language World History, U.S. History and Comparative Government & Politics.

### **Extracurricular Activities**

The School offers a variety of after-school activities and Saturday school for all students free of charge ranging from tutoring to athletic teams. All subject teachers are required to have tutoring sessions twice a week, and a fun/sport club once a week. Examples of activities include: Girls' Club, Digital Art, College Mentorship and Leadership Program (CMLP), Stand-up Comedy Club, Food Prep-Cooking Club, Cheerleaders Club, SRLA, Soccer Club, Calculus Club, Craft Club, Theatre/Acting Club, Video Game Club, Movie Club, Ping Pong Club, Early Morning Walk Club, Horror Make-up Club, Volleyball Club and Robotics Club.

### **Parent-Student-Teacher Cooperation**

The School works with parents to increase their awareness of the importance of their involvement in their children's education through the following activities:

- *Individualized parent counseling.* Teachers and mentors will be assigned to a small group of students. They will arrange two to four meetings with each parent during the school year to discuss their students' academic achievements.
- *Parent Volunteer Hours.* A voluntary time commitment is requested. There are multiple areas of volunteering available, including classroom teacher support, clerical, site improvements, field trips, and fundraising .
- *One-on-one Meetings.* The School holds one-on-one meetings with parents of academically low-achieving students to assist the parent in providing support to the student.
- *Small Class Sizes.* The average number of students per class at the School will be 25 in order to guarantee close communication between teacher and student.
- *Sustained Reading Time.* All students, teachers and administrators read for 25 minutes every day during a dedicated time that is part of the structured school day.
- *Online Portal.* The School uses CoolSIS, an online web portal, to enable parents, students and teachers to communicate more efficiently.



## FINANCIAL PERFORMANCE OF THE SCHOOL

See Appendix B for the audited financial statements of the School and MERF for the fiscal year ended June 30, 2013. Historic and projected operating results as well as projected debt service coverage and cash on hand computations are also included.

**Table A-9**  
**Magnolia Science Academy**  
**Statement of Financial Position<sup>(1)</sup>**  
**Fiscal Years Ended June 30, 2009-2013**

| Fiscal Year Ending June 30              | Audit<br>2009     | Audit<br>2010     | Audit<br>2011       | Audit<br>2012       | Audit<br>2013       |
|---|-------------------|-------------------|---------------------|---------------------|---------------------|
| <b>ASSETS</b>                           |                   |                   |                     |                     |                     |
| <b>Current assets:</b>                  |                   |                   |                     |                     |                     |
| Cash and cash equivalents               | \$ 219,759        | \$ 480,084        | \$ -                | \$ 47,821           | \$ 146,235          |
| Prepaid expenses                        | -                 | -                 | -                   | 118,725             |                     |
| Intercompany receivable <sup>(2)</sup>  | -                 | -                 | 322,509             | 793,509             | 1,171,976           |
| Accounts receivable <sup>(3)</sup>      | -                 | 258,953           | 1,048,087           | 1,050,904           | 530,628             |
| Total current assets                    | 219,759           | 739,037           | 1,370,596           | 2,010,959           | 1,835,839           |
| <b>Property and equipment:</b>          |                   |                   |                     |                     |                     |
| Equipment                               | 206,577           | 206,577           | 214,520             | 214,520             | 228,399             |
| Leasehold Improvements                  | 363,748           | 363,748           | 363,748             | 363,748             | 363,748             |
| Less: accumulated depreciation          | (537,254)         | (570,325)         | (571,119)           | (571,913)           | (579,656)           |
| Net property and equipment              | 33,071            | -                 | 7,149               | 6,355               | 12,491              |
| <b>Other assets:</b>                    |                   |                   |                     |                     |                     |
| Security Deposits                       | 39,035            | 39,035            | 39,035              | 39,035              | 39,035              |
| Total other assets                      | 39,035            | 39,035            | 39,035              | 39,035              | 39,035              |
| <b>Total Assets</b>                     | <b>\$ 291,865</b> | <b>\$ 778,072</b> | <b>\$ 1,416,780</b> | <b>\$ 2,056,349</b> | <b>\$ 1,900,365</b> |
| <b>LIABILITIES AND NET ASSETS</b>       |                   |                   |                     |                     |                     |
| <b>Current liabilities:</b>             |                   |                   |                     |                     |                     |
| Accounts payable                        | \$ 19,742         | \$ 14,635         | \$ 284,366          | \$ 284,502          | \$ 328,568          |
| Accrued payroll liabilities             | -                 | 42,857            | 140                 | 18,632              | 16,008              |
| Loan payable                            | -                 | 5,000             | 33,600              | 830,000             | 140,000             |
| Total current liabilities               | 19,742            | 62,492            | 318,106             | 1,133,134           | 484,576             |
| <b>Net assets:</b>                      |                   |                   |                     |                     |                     |
| Unrestricted net assets (deficit)       | 272,123           | 715,580           | 1,098,674           | 923,215             | 1,415,789           |
| Total net assets                        | 272,123           | 715,580           | 1,098,674           | 923,215             | 1,415,789           |
| <b>Total Liabilities and Net Assets</b> | <b>\$ 291,865</b> | <b>\$ 778,072</b> | <b>\$ 1,416,780</b> | <b>\$ 2,056,349</b> | <b>\$ 1,900,365</b> |

<sup>(1)</sup> Adapted from Magnolia Science Academy audited financial statements for the Fiscal Years 2008-09 through 2012-13.

<sup>(2)</sup> Includes Fiscal Year 2013 intercompany receivable of \$1,171,976 that was repaid in full as of October 5, 2013.

<sup>(3)</sup> Includes the following accruals that were subject to a State deferral and received by the School in the following Fiscal Years: \$258,953 accrued to Fiscal Year 2009-10; \$779,487 accrued to Fiscal Year 2010-11; \$839,710 accrued to Fiscal Year 2011-12; and an estimated \$213,564 accrued to Fiscal Year 2012-13.

**Table A-10**  
**Magnolia Science Academy**  
**Historical Revenue and Expenditure Statement**  
**Fiscal Years Ended June 30, 2009-2013**

| Fiscal Year Ending June 30            | Audit<br>2009       | Audit<br>2010       | Audit<br>2011       | Audit<br>2012       | Audit<br>2013       |
|---------------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| <b>REVENUES</b>                       |                     |                     |                     |                     |                     |
| Federal support                       | \$ 264,330          | \$ 250,003          | \$ 482,667          | \$ 278,608          | \$ 450,131          |
| State support                         | 2,720,493           | 2,798,124           | 3,035,738           | 2,780,271           | 3,074,684           |
| Local support                         | 1,118,601           | 1,015,875           | 802,645             | 697,906             | 666,038             |
| Private contribution                  | -                   | 14,569              | -                   | 309,123             | 70,665              |
| Other revenues                        | 9,001               | 26,099              | -                   | 156,914             | 96,074              |
| <b>Total Revenue</b>                  | <b>\$ 4,112,425</b> | <b>\$ 4,104,670</b> | <b>\$ 4,321,050</b> | <b>\$ 4,222,822</b> | <b>\$ 4,360,592</b> |
| <b>EXPENSES</b>                       |                     |                     |                     |                     |                     |
| Certified salaries                    | \$ 1,265,327        | \$ 1,052,984        | \$ 1,326,081        | \$ 1,740,309        | \$ 1,488,387        |
| Classified salaries                   | 317,606             | 260,305             | 175,983             | 240,941             | 246,151             |
| Fringe benefits                       | 574,805             | 720,876             | 475,561             | 540,698             | 406,031             |
| Books and supplies                    | 269,639             | 231,869             | 486,273             | 403,757             | 286,956             |
| Services and other operating expenses | 1,363,640           | 1,356,484           | 1,469,590           | 1,462,011           | 1,360,142           |
| Depreciation                          | 30,636              | 33,071              | 794                 | 794                 | 7,734               |
| Capital Outlay                        | 13,587              | -                   | -                   | -                   | 27,496              |
| Debt service                          | -                   | -                   | -                   | -                   | -                   |
| Interest Expense                      | 10,185              | 5,624               | 3,674               | 9,771               | 45,112              |
| <b>Total Expenses</b>                 | <b>\$ 3,845,425</b> | <b>\$ 3,661,213</b> | <b>\$ 3,937,956</b> | <b>\$ 4,398,281</b> | <b>\$ 3,868,018</b> |
| <b>Change in Net Assets</b>           | <b>\$ 267,000</b>   | <b>\$ 443,457</b>   | <b>\$ 383,094</b>   | <b>\$ (175,459)</b> | <b>\$ 492,574</b>   |
| <b>Net assets, beginning of year</b>  | <b>5,123</b>        | <b>272,123</b>      | <b>715,580</b>      | <b>1,098,674</b>    | <b>923,215</b>      |
| <b>Net assets, end of year</b>        | <b>\$ 272,123</b>   | <b>\$ 715,580</b>   | <b>\$ 1,098,674</b> | <b>\$ 923,215</b>   | <b>\$ 1,415,789</b> |

*Source:* Magnolia Science Academy audited financial statements for the Fiscal Years 2008-09 through 2012-13.

**Table A-11**  
**Magnolia Science Academy**  
**Projected Statement of Activities and Changes in Net Assets**  
**Fiscal Years Ending June 30, 2014-2018**

| Fiscal Year Ending June 30            | 2014 <sup>(1)</sup> | 2015 <sup>(2)</sup> | 2016 <sup>(2)</sup> | 2017 <sup>(2)</sup> | 2018 <sup>(2)</sup> |
|---------------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| <b>REVENUE</b>                        |                     |                     |                     |                     |                     |
| Federal support <sup>(3)</sup>        | \$ 866,641          | \$ 853,010          | \$ 853,010          | \$ 853,010          | \$ 853,010          |
| State support <sup>(4)</sup>          | 3,514,732           | 3,999,198           | 4,428,936           | 4,744,243           | 5,059,551           |
| Local support                         | 730,413             | 752,608             | 752,608             | 752,608             | 752,608             |
| Other revenues                        | 70,000              | 70,000              | 70,000              | 70,000              | 70,000              |
| <b>Total Revenue</b>                  | <u>\$ 5,181,786</u> | <u>\$ 5,674,816</u> | <u>\$ 6,104,554</u> | <u>\$ 6,419,861</u> | <u>\$ 6,735,169</u> |
| <b>EXPENSES</b>                       |                     |                     |                     |                     |                     |
| Certified salaries                    | \$ 1,645,438        | \$ 1,659,076        | \$ 1,728,996        | \$ 1,746,226        | \$ 1,813,660        |
| Classified salaries                   | 328,000             | 331,280             | 334,593             | 337,939             | 341,318             |
| Fringe benefits                       | 517,109             | 519,532             | 535,849             | 538,756             | 559,081             |
| Books and supplies                    | 609,277             | 626,813             | 568,439             | 568,439             | 569,689             |
| Services and other operating expenses | 1,479,350           | 1,159,751           | 1,235,162           | 1,272,999           | 1,335,115           |
| Depreciation                          | 10,000              | 15,000              | 15,000              | 15,000              | 15,000              |
| Lease Payments <sup>(5)</sup>         | -                   | 442,896             | 442,888             | 442,288             | 441,338             |
| <b>Total Expenses</b>                 | <u>\$ 4,589,174</u> | <u>\$ 4,754,347</u> | <u>\$ 4,860,926</u> | <u>\$ 4,921,646</u> | <u>\$ 5,075,201</u> |
| <b>Change in Net Assets</b>           | \$ 592,612          | \$ 920,469          | \$ 1,243,628        | \$ 1,498,215        | \$ 1,659,968        |
| <b>Net Assets, Beginning of Year</b>  | <u>1,415,789</u>    | <u>2,008,401</u>    | <u>2,928,870</u>    | <u>4,172,497</u>    | <u>5,670,713</u>    |
| <b>Net Assets, Ending of Year</b>     | <u>\$ 2,008,401</u> | <u>\$ 2,928,870</u> | <u>\$ 4,172,497</u> | <u>\$ 5,670,713</u> | <u>\$ 7,330,681</u> |

(1) Budgeted.

(2) Projected.

(3) Reflects additional revenues from 5-year 21st Century High School After School Safety and Enrichment for Teens ("ASSET") grant of federal funds through a program administered by the California Department of Education.

(4) Includes S.B. 740 facilities funding.

(5) Reflects required lease payments to MPM Sherman Way LLC, to be applied to repayment of the 2014 Bonds.

Source: Magnolia Science Academy

**Table A-12**  
**Magnolia Science Academy**  
**Statement of Projected Debt Service Coverage**  
**Fiscal Years Ending June 30, 2014-2018**

| Fiscal Year Ending June 30  | <b>2014</b> | <b>2015</b>  | <b>2016</b>  | <b>2017</b>  | <b>2018</b>  |
|---|-------------|--------------|--------------|--------------|--------------|
| Net Revenue   | \$ 592,612  | \$ 920,469   | \$ 1,243,628 | \$ 1,498,215 | \$ 1,659,968 |
| Adjustments   |             |              |              |              |              |
| Depreciation  | 10,000      | 15,000       | 15,000       | 15,000       | 15,000       |
| Debt Service Requirements   | -           | 442,896      | 442,888      | 442,288      | 441,338      |
| Revenue Available for Lease / Debt Service Payments                   | \$ 602,612  | \$ 1,378,364 | \$ 1,701,515 | \$ 1,955,503 | \$ 2,116,305 |
| Scheduled Lease / Debt Service Payments                               | \$ -        | \$ 442,896   | \$ 442,888   | \$ 442,288   | \$ 441,338   |
| Lease / Debt Service Payments Coverage Ratio (current year)           | N/A         | 3.11         | 3.84         | 4.42         | 4.80         |
| Maximum Annual Debt Service Payments                                  | \$ 446,563  | \$ 446,563   | \$ 446,563   | \$ 446,563   | \$ 446,563   |
| Debt Service Payments Coverage (Maximum Annual Debt Service Payments) | 1.35        | 3.09         | 3.81         | 4.38         | 4.74         |

*Source:* Magnolia Science Academy

**APPENDIX B**

**AUDITED FINANCIAL STATEMENTS FOR THE SCHOOL AND MAGNOLIA  
EDUCATIONAL & RESEARCH FOUNDATION FOR  
FISCAL YEARS ENDED JUNE 30, 2013**

**AND UNAUDITED FINANCIAL STATEMENTS OF THE SCHOOL AND OF MAGNOLIA  
EDUCATIONAL & RESEARCH FOUNDATION  
FOR THE PERIOD FROM JULY 1, 2013 THROUGH MARCH 31, 2014**

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***MAGNOLIA SCIENCE ACADEMY  
AUDITED FINANCIAL STATEMENTS  
FOR THE YEAR ENDED  
JUNE 30, 2013***

# ***MAGNOLIA SCIENCE ACADEMY***

## **TABLE OF CONTENTS**

|  | <u>Page</u> |
|--|-------------|
| Independent auditor's report   | 3           |
| Statement of financial position  | 5           |
| Statement of activities  | 6           |
| Statement of cash flows  | 7           |
| Notes to financial statements  | 8           |
| <br><b>SUPPLEMENTARY INFORMATION:</b>  |             |
| Local educational agency organization structure  | 12          |
| Schedule of average daily attendance   | 13          |
| Schedule of instructional time   | 13          |
| <br><b>SUPPLEMENTARY INFORMATION REQUIRED BY GOVERNMENT<br/>AUDITING STANDARDS:</b>  |             |
| Independent auditor's report on internal control over financial reporting<br>and on compliance and other matters based on an audit of financial<br>statements performed in accordance with Government Auditing Standards | 15          |
| Independent auditor's report on state compliance   | 17          |
| Schedule of findings and questioned costs  | 20          |
| Reconciliation of unaudited actuals to audited financial statements  | 21          |



# **HILL, MORGAN AND ASSOCIATES, LLP**

## ***Certified Public Accountants***

19602 Fariman Drive Carson, CA 90746 Phone (310) 749-1014 Fax (310) 639-0498  
9031 Krueger Street, Culver City, CA 90232 Phone (323) 377-4385 Fax (310) 836-5727

Partners  
Jeffrey Hill, CPA  
Raymond Morgan, CPA

To the Board of Directors  
**Magnolia Science Academy**  
Reseda, California

### **INDEPENDENT AUDITOR'S REPORT**

We have audited the accompanying financial statements of **Magnolia Science Academy** which comprise the statement of financial position as of June 30, 2013, and the related statements of activities and cash flow for the year then ended, and the related notes to the financial statements. The prior year summarized comparative information has been derived from the organization's 2012 financial statements and in our report dated October 15, 2012 an unqualified opinion was expressed on those financial statements.

#### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the Education Audit Appeals Panel's *Standards and Procedures for Audits of California K-12 Local Educational Agencies*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such

opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **Magnolia Science Academy** as of June 30, 2013, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America

### **Other Reporting Required by Government Auditing Standards**

In accordance with Government Auditing Standards, we have also issued our report dated October 21, 2013 on our consideration of the **Magnolia Science Academy's** internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit

*Hill, Morgan and Associates, LLP*

Carson, California  
October 21, 2013

**MAGNOLIA SCIENCE ACADEMY**  
**STATEMENT OF FINANCIAL POSITION**  
At June 30, 2013  
(With comparative totals at June 30, 2012)

|   | <u>2013</u>                | <u>2012</u>                |
|---|----------------------------|----------------------------|
| <b>ASSETS</b>                           |                            |                            |
| <b>CURRENT ASSETS:</b>                  |                            |                            |
| Cash and cash equivalents               | \$ 146,235                 | \$ 47,821                  |
| Prepaid expense                         |                            | 118,725                    |
| Intercompany receivable (Note 2)        | 1,171,976                  | 793,509                    |
| Accounts receivable                     | <u>530,628</u>             | <u>1,050,904</u>           |
| <b>Total current assets</b>             | <u>1,848,839</u>           | <u>2,010,959</u>           |
| <b>PROPERTY AND EQUIPMENT:</b>          |                            |                            |
| Equipment                               | 228,399                    | 214,520                    |
| Leasehold improvements                  | 363,748                    | 363,748                    |
| Less: accumulated depreciation          | <u>(579,656)</u>           | <u>(571,913)</u>           |
| <b>Net property and equipment</b>       | <u>12,491</u>              | <u>6,355</u>               |
| <b>OTHER ASSETS:</b>                    |                            |                            |
| Security deposits                       | <u>39,035</u>              | <u>39,035</u>              |
| <b>Total other assets</b>               | <u>39,035</u>              | <u>39,035</u>              |
| <b>Total assets</b>                     | <u><u>\$ 1,900,365</u></u> | <u><u>\$ 2,056,349</u></u> |
| <b>LIABILITIES AND NET ASSETS</b>       |                            |                            |
| <b>CURRENT LIABILITIES:</b>             |                            |                            |
| Accounts payable                        | \$ 328,568                 | \$ 284,502                 |
| Accrued payroll liabilities             | 16,008                     | 18,632                     |
| Advances on program revenue (Note 3)    | 140,000                    |                            |
| Loans payable                           |                            | <u>830,000</u>             |
| <b>Total current liabilities</b>        | <u>484,576</u>             | <u>1,133,134</u>           |
| <b>NET ASSETS:</b>                      |                            |                            |
| Unrestricted                            | <u>1,415,789</u>           | <u>923,215</u>             |
| <b>Total net assets</b>                 | <u>1,415,789</u>           | <u>923,215</u>             |
| <b>Total liabilities and net assets</b> | <u><u>\$ 1,900,365</u></u> | <u><u>\$ 2,056,349</u></u> |

The accompanying notes are an integral part of these financial statements.

**MAGNOLIA SCIENCE ACADEMY**  
**STATEMENT OF ACTIVITIES**  
For the year ended June 30, 2013  
(With comparative totals for the year ended June 30, 2012)

|  | <u>2013</u>                | <u>2012</u>              |
|--|----------------------------|--------------------------|
| <b>REVENUES:</b>                         |                            |                          |
| Federal support                          | \$ 450,131                 | \$ 278,608               |
| State support                            | 3,074,684                  | 2,780,271                |
| Local support                            | 669,038                    | 697,906                  |
| Private contributions                    | 70,665                     | 309,123                  |
| Other revenues                           | <u>96,074</u>              | <u>156,914</u>           |
| <b>Total revenues</b>                    | <u>4,360,592</u>           | <u>4,222,822</u>         |
| <b>EXPENSES:</b>                         |                            |                          |
| Certificated salaries                    | 1,488,387                  | 1,740,309                |
| Classified salaries                      | 246,151                    | 240,941                  |
| Fringe benefits                          | 406,031                    | 540,698                  |
| Books and supplies                       | 286,956                    | 403,757                  |
| Services and other operating expenses    | 1,360,142                  | 1,462,011                |
| Depreciation                             | 7,743                      | 794                      |
| Interest expense                         | 45,112                     | 9,771                    |
| Capital outlay                           | <u>27,496</u>              | <u></u>                  |
| <b>Total expenses</b>                    | <u>3,868,018</u>           | <u>4,398,281</u>         |
| <b>Increase (decrease) in net assets</b> | 492,574                    | (175,459)                |
| Net assets, beginning of the year        | <u>923,215</u>             | <u>1,098,674</u>         |
| <b>Net assets, end of the year</b>       | <u><u>\$ 1,415,789</u></u> | <u><u>\$ 923,215</u></u> |

The accompanying notes are an integral part of these financial statements.

**MAGNOLIA SCIENCE ACADEMY**  
**STATEMENT OF CASH FLOWS**  
For the year ended June 30, 2013  
(With comparative totals for the year ended June 30, 2013)

|  | <u>2013</u>              | <u>2012</u>             |
|--|--------------------------|-------------------------|
| <b>Cash flows from operating activities:</b>   |                          |                         |
| Increase (decrease) in net assets  | \$ 492,574               | \$ (175,459)            |
| <b>Adjustments to reconcile change in net assets to net cash provided by operating activities:</b> |                          |                         |
| Depreciation   | 7,743                    | 794                     |
| <b>Changes in operating assets and liabilities:</b>  |                          |                         |
| (Increase) decrease in assets:   |                          |                         |
| Prepaid expense  | 118,725                  | (118,725)               |
| Accounts receivable  | 520,276                  | (2,817)                 |
| Intercompany receivable  | (378,467)                | (471,000)               |
| Increase (decrease) in liabilities:  |                          |                         |
| Accounts payable   | 44,066                   | 136                     |
| Advances on program revenue  | 140,000                  |                         |
| Accrued payroll liabilities  | <u>(2,624)</u>           | <u>18,492</u>           |
| <b>Net cash provided by (used in) operating activities</b>   | <u>942,293</u>           | <u>(748,579)</u>        |
| <b>Cash flows from financing activities:</b>   |                          |                         |
| Proceeds from loans payable  |                          | 830,000                 |
| Cash used to pay down loan principal   | <u>(830,000)</u>         | <u>(33,600)</u>         |
| <b>Net cash provided by (used in) financing activities</b>   | <u>(830,000)</u>         | <u>796,400</u>          |
| <b>Net increase in cash</b>  | <u>98,414</u>            | <u>47,821</u>           |
| Cash and cash equivalents, beginning of the year   | <u>47,821</u>            | <u>-</u>                |
| <b>Cash and cash equivalents, end of the year</b>  | <u><u>\$ 146,235</u></u> | <u><u>\$ 47,821</u></u> |
| <b>SUPPLEMENTAL INFORMATION:</b>   |                          |                         |
| Cash paid for interest expense   | <u><u>\$ 45,112</u></u>  | <u><u>\$ 9,771</u></u>  |

The accompanying notes are an integral part of these financial statements.

# **MAGNOLIA SCIENCE ACADEMY**

## **NOTES TO FINANCIAL STATEMENTS**

### **NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **NATURE OF BUSINESS**

Magnolia Science Academy (School) is a charter school located in Reseda, California that provides sixth through twelfth grade education to approximately 475 students. The School was created under the approval of the Los Angeles Unified School District and the California State Board of Education, and receives public per-pupil funding to help support their operation. The School is economically dependent on Federal and State funding.

#### **FINANCIAL STATEMENT PRESENTATION**

The accompanying financial statements are prepared on the accrual basis in accordance with the AICPA's Audit and Accounting Guide, "Not-for-Profit Organizations."

#### **ESTIMATES**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of management estimates and assumptions that could affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

#### **CASH AND CASH EQUIVALENTS**

For the purpose of the Statement of Cash Flows, the School considers all highly liquid investments available for current use with an initial maturity of three months or less to be cash equivalents.

#### **INCOME TAXES**

The School is considered to be a local school district for tax purposes. Accordingly, no provisions for income taxes or related credits are included in the accompanying financial statements.

#### **PROPERTY AND EQUIPMENT**

Property and equipment is capitalized at cost or fair market value on the date of receipt in the case of donated property. Depreciation is provided on the straight-line method over the estimated useful lives of the assets ranging from 3 to 10 years. Leasehold improvements are depreciated over the lease term (including options) or the useful life. Major additions are capitalized, and repairs and maintenance that do not improve or extend the life of the assets are expensed. When assets are sold or retired their cost and the related accumulated depreciation are removed from the accounts with the resulting gain or loss reflected in the Statement of Activities.

These notes are an integral part of the preceding financial statements.

# **MAGNOLIA SCIENCE ACADEMY**

## **NOTES TO FINANCIAL STATEMENTS**

### ***NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)***

#### **COMPARATIVE FINANCIAL INFORMATION**

The financial statements include certain prior-year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the School's financial statements for the year ended June 30, 2012 from which the summarized information was derived.

### ***NOTE 2 - INTERCOMPANY RECEIVABLE***

The June 30, 2013 intercompany receivable results from a net cumulative difference between resources provided by Magnolia Educational and Research Foundation (Foundation) to the School and reimbursement for those resources from the School to the Foundation, and cash transfers for cash flow purposes. The School and the Foundation are related because they are the same legal entity, share the same tax identification number, governed by the same board of directors and share key management personnel. On June 30, 2013, the School had an intercompany receivable balance of \$1,171,977 from the Foundation (see note 6).

### ***NOTE 3 - ADVANCES ON PROGRAM REVENUE***

As of June 30, 2012 the School received cash advances on per-pupil revenue projections from subsequent years from an entity independent of the California State Board of Education and local school districts. These advances were secured by, and to be repaid with, the expected receipts of these projected per-pupil revenues from State and Local sources in the subsequent year.

These notes are an integral part of the preceding financial statements.

# MAGNOLIA SCIENCE ACADEMY

## NOTES TO FINANCIAL STATEMENTS

### **NOTE 4 – OPERATING LEASES**

The School leases its facilities in Reseda, California, under an operating lease until July 31, 2017 with monthly payments of \$30,057. The School also leases its gymnasium under an operating lease until July 31, 2017 with a monthly payment of \$11,773. Total rent and repair expense during the year ended June 30, 2013 was \$535,563.

The future minimum lease commitments are as follows:

| <u>For the year ended June 30,</u> | <u>Educ. Facility</u> | <u>Gym</u>        | <u>Total</u>        |
|------------------------------------|-----------------------|-------------------|---------------------|
| 2014                               | \$ 360,684            | \$ 141,276        | \$ 501,960          |
| 2015                               | 360,684               | 145,158           | 505,842             |
| 2016                               | 360,684               | 149,516           | 510,200             |
| 2017                               | 360,684               | 154,005           | 514,689             |
| 2018                               | <u>30,057</u>         | <u>12,865</u>     | <u>42,922</u>       |
| Total                              | \$ <u>1,472,793</u>   | \$ <u>602,820</u> | \$ <u>2,075,613</u> |

### **NOTE 5 – CONCENTRATION OF CREDIT RISK**

The School maintains its cash accounts with local banks. The cash balance is insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 per banking institution. As of June 30, 2013, the School had cash deposits that are above the balance insured by the FDIC in the amount of \$80,921.

### **NOTE 6 – SUBSEQUENT EVENTS**

The School's Management has evaluated subsequent events for the period from June 30, 2013 through October 24, 2013, the date the financial statements were available to be issued. Management identified the following transactions that require disclosure or that would have an impact on the financial statements.

The School received the full amount of the intercompany receivable due from the foundation on October 18, 2013.

Effective on October 15, 2013, The School secured a Charter School Facility Grant from the California School Finance Authority. The grant in the amount of \$356,490 will be used for the facility rent during fiscal year 2013-2014.

These notes are an integral part of the preceding financial statements.



***SUPPLEMENTARY INFORMATION***

## **MAGNOLIA SCIENCE ACADEMY**

### **SUPPLEMENTARY INFORMATION**

#### **LOCAL EDUCATIONAL AGENCY ORGANIZATION STRUCTURE**

|                          |                          |
|--------------------------|--------------------------|
| Name of School           | Magnolia Science Academy |
| Sponsoring District      | LAUSD                    |
| Original date of charter | 7/1/2002                 |
| Charter expiration date  | 6/30/2017                |

#### **GOVERNING BOARD**

| <u>Member</u>                 | <u>Title</u> | <u>Term Expires</u> |
|-------------------------------|--------------|---------------------|
| Umit Yapanel, Ph.D.           | President    | 10/11/17            |
| Saken Sherkhanov              | Secretary    | 11/12/13            |
| Dr. Bayram Yenikaya, Ph.D.    | Director     | 11/18/14            |
| Dr. Mustafa Kaynak, Ph.D.     | Director     | 10/11/17            |
| Mr. Francisco Huidobro        | Director     | 10/11/17            |
| Mrs. Noel Russell-Unterburger | Director     | 10/11/17            |

#### **MANAGEMENT TEAM**

Mustafa Sahin - Principal  
Mekan Muhammedov, Chief Financial Officer

# MAGNOLIA SCIENCE ACADEMY

## SUPPLEMENTARY INFORMATION

### **SCHEDULE OF AVERAGE DAILY ATTENDANCE**

|  | <u>Annual ADA</u>    | <u>Second Period<br/>ADA</u> |
|--|----------------------|------------------------------|
| <b><i>Elementary School</i></b>            |                      |                              |
| Grades four through six-classroom based    | 82.32                | 82.03                        |
| Grades seven through eight-classroom based | 163.24               | 164.33                       |
| <b><i>High School</i></b>                  |                      |                              |
| Grades nine through twelve-classroom based | <u>229.18</u>        | <u>229.96</u>                |
| Total                                      | <u><u>474.74</u></u> | <u><u>476.32</u></u>         |

The above schedule of average daily attendance is a measurement of the number of pupils attending classes of the School. The purpose of attendance accounting from a fiscal standpoint is to provide the basis on which apportionments of state funds are made to charter schools. This schedule provides information regarding the attendance of students at various grade levels.

### **SCHEDULE OF INSTRUCTIONAL TIME**

| <u>Grade level</u> | <u>Minute<br/>requirement</u> | <u>Actual<br/>Minutes</u> | <u>Number<br/>of days</u> | <u>Status</u> |
|--------------------|-------------------------------|---------------------------|---------------------------|---------------|
| Grade 4            | 52,457                        | 65,502                    | 176                       | Complied      |
| Grade 5            | 52,457                        | 65,502                    | 176                       | Complied      |
| Grade 6            | 52,457                        | 65,502                    | 176                       | Complied      |
| Grade 7            | 52,457                        | 65,502                    | 176                       | Complied      |
| Grade 8            | 52,457                        | 65,502                    | 176                       | Complied      |
| Grade 9            | 62,949                        | 66,502                    | 176                       | Complied      |
| Grade 10           | 62,949                        | 66,502                    | 176                       | Complied      |
| Grade 11           | 62,949                        | 66,502                    | 176                       | Complied      |
| Grade 12           | 62,949                        | 66,502                    | 176                       | Complied      |

The above schedule presents information on the amount of instructional time offered by the School and whether the School complied with the provisions of Education Code Sections 46200 through 46206.

***SUPPLEMENTARY INFORMATION SECTION REQUIRED BY  
GOVERNMENT AUDITING STANDARDS***

# HILL, MORGAN AND ASSOCIATES, LLP

## *Certified Public Accountants*

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9031 Krueger Street, Culver City, CA 90232 Phone (323) 377-4385 Fax (310) 836-5727

Partners  
Jeffrey Hill, CPA  
Raymond Morgan, CPA

To the Board of Directors  
**Magnolia Science Academy**  
Reseda, California

### **INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

We have audited the financial statements of **Magnolia Science Academy** as of and for the year ended June 30, 2013 and have issued our report thereon dated October 21, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

#### Internal Control Over Financial Reporting

In planning and performing our audit, we considered **Magnolia Science Academy's** internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of **Magnolia Science Academy's** internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of **Magnolia Science Academy's** internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether **Magnolia Science Academy's** financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended solely for the information and use of **Magnolia Science Academy's** management, the State Controller's Office, and the Department of Education, and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Hill, Morgan and Associates, LLP

Carson, California  
October 21, 2013

# HILL, MORGAN AND ASSOCIATES, LLP

## *Certified Public Accountants*

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9031 Krueger Street, Culver City, CA 90232 Phone (323) 377-4385 Fax (310) 836-5727

Partners  
Jeffrey Hill, CPA  
Raymond Morgan, CPA

To the Board of Directors  
**Magnolia Science Academy**  
Reseda, California

### **INDEPENDENT AUDITOR'S REPORT ON STATE COMPLIANCE**

We have audited **Magnolia Science Academy's** compliance with the types of compliance requirements described in the Standards and Procedures for Audits of California K-12 Local Educational Agencies 2012-13, published by the Education Audit Appeals Panel, for the year ended June 30, 2013. The School's State programs are identified in the schedule below. Compliance with the requirements of laws, regulations, contracts, and grants is the responsibility of the School's management. Our responsibility is to express an opinion on **Magnolia Science Academy's** compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and Standards and Procedures for Audits of California K-12 Local Educational Agencies 2012-13. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to below occurred. An audit includes examining, on a test basis, evidence about **Magnolia Science Academy's** compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the School's compliance with those requirements:

|  | <u>Procedures in<br/>Audit Guide</u> | <u>Procedures<br/>performed</u> |
|--|--------------------------------------|---------------------------------|
| Attendance Accounting:                   |                                      |                                 |
| Attendance reporting                     | 6                                    | Not applicable                  |
| Teacher certification and misassignments | 3                                    | Not applicable                  |
| Kindergarten continuance                 | 3                                    | Not applicable                  |
| Independent study                        | 23                                   | Not applicable                  |
| Continuation education                   | 10                                   | Not applicable                  |

|   | Procedures in<br>Audit Guide | Procedures<br>Performed |
|---|------------------------------|-------------------------|
| Instructional Time:   |                              |                         |
| School districts  | 6                            | Not applicable          |
| County offices of education   | 3                            | Not applicable          |
| Instructional Materials:  |                              |                         |
| General requirements  | 8                            | Not applicable          |
| Ratios of Administrative Employees to Teachers                          | 1                            | Not applicable          |
| Classroom teacher salaries  | 1                            | Not applicable          |
| Early retirement incentive  | 4                            | Not applicable          |
| Gann limit calculation  | 1                            | Not applicable          |
| School accountability report cards                                      | 3                            | Not applicable          |
| Public hearing requirements-receipt of funds                            | 1                            | Not applicable          |
| Juvenile court schools  | 8                            | Not applicable          |
| Exclusion of pupils-Pertussis immunization                              | 2                            | Not applicable          |
| Class Size Reduction Program (Including Charter School):                |                              |                         |
| General requirements  | 7                            | Not applicable          |
| Option one classes  | 3                            | Not applicable          |
| Option two classes  | 4                            | Not applicable          |
| District or charter schools with only one school                        |                              |                         |
| Servicing K-3   | 4                            | Not applicable          |
| After school education and safety program: (Including Charter Schools): |                              |                         |
| General requirements  | 4                            | Not applicable          |
| After school  | 5                            | Not applicable          |
| Before school   | 6                            | Not applicable          |
| Charter Schools:  |                              |                         |
| Contemporaneous record of attendance                                    | 1                            | Yes                     |
| Mode of instructions  | 1                            | Yes                     |
| Non classroom-based instruction/independent study                       | 15                           | Not applicable          |
| Determination of funding for non classroom-based instruction            | 3                            | Not applicable          |
| Annual instructional minutes-classroom based                            | 4                            | Yes                     |



In our opinion, **Magnolia Science Academy** complied, in all material respects, with the compliance requirements referred to on the previous page for the year ended June 30, 2013.

This report is intended solely for the information and use of **Magnolia Science Academy's** management, the State Controller's Office, and the Department of Education, and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

*Hill, Morgan and Associates, LLP*

Carson, California  
October 21, 2013

## **MAGNOLIA SCIENCE ACADEMY**

### **SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

#### **FINANCIAL STATEMENT FINDINGS**

None noted.

#### **STATE AWARDS FINDINGS AND QUESTIONED COSTS**

None noted.

#### **STATUS OF PRIOR YEAR FINDINGS**

There were no prior year findings noted.

**MAGNOLIA SCIENCE ACADEMY**  
**RECONCILIATION OF UNAUDITED ACTUALS**  
**WITH AUDITED FINANCIAL STATEMENTS**  
For the year ended June 30, 2013

|  |           |
|--|-----------|
| <b>June 30, 2013, annual financial and budget<br/>report fund balance:</b> | 1,505,308 |
|--|-----------|

**Adjustments:**

|                                     |                 |
|-------------------------------------|-----------------|
| Revenue and accounts receivable     | (21,309)        |
| Depreciation expense                | (7,743)         |
| Other expenses and accounts payable | <u>(60,467)</u> |

|                           |                 |
|---------------------------|-----------------|
| <b>Total adjustments:</b> | <u>(89,519)</u> |
|---------------------------|-----------------|

|  |                         |
|--|-------------------------|
| <b>June 30, 2013 audited financial statements net assets</b> | <u><u>1,415,789</u></u> |
|--|-------------------------|

This schedule provides the information necessary to reconcile the net assets as reported on the Charter School Unaudited Actuals Financial Report-Alternative Form

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***MAGNOLIA EDUCATIONAL AND RESEARCH  
FOUNDATION  
CONSOLIDATED AUDITED  
FINANCIAL STATEMENTS  
FOR THE YEAR ENDED  
JUNE 30, 2013***

***MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION***

**TABLE OF CONTENTS**

|  | <u>Page</u> |
|--|-------------|
| Independent auditor's report                 | 3           |
| Consolidated statement of financial position | 4           |
| Consolidated statement of activities         | 5           |
| Consolidated statement of cash flows         | 6           |
| Notes to consolidated financial statements   | 8           |

# HILL, MORGAN AND ASSOCIATES, LLP

## *Certified Public Accountants*

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Partners  
Jeffrey Hill, CPA  
Raymond Morgan, CPA

To the Board of Directors of the  
**Magnolia Educational and Research Foundation**  
Westminster, California

### **INDEPENDENT AUDITOR'S REPORT**

We have audited the accompanying financial statements of **Magnolia Educational and Research Foundation**, which comprise the statement of financial position as of June 30, 2013, and the related statements of activities and cash flow for the year then ended, and the related notes to the financial statements. The prior year summarized comparative information has been derived from the organization's 2012 financial statements and in our report dated December 23, 2012 an unqualified opinion was expressed on those financial statements.

#### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **Magnolia Educational and Research Foundation** as of June 30, 2013, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Hall, Morgan and Associates, LLP". The signature is written in a cursive, flowing style.

Carson, California  
October 21, 2013



**MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

At June 30, 2013

(With comparative totals at June 30, 2012)

|   | <u>Unrestricted</u> | <u>Temporarily<br/>restricted</u> | <u>2013<br/>Total</u> | <u>2012<br/>Total</u> |
|---|---------------------|-----------------------------------|-----------------------|-----------------------|
| <b>ASSETS</b>                                 |                     |                                   |                       |                       |
| <b>CURRENT ASSETS:</b>                        |                     |                                   |                       |                       |
| Cash and cash equivalents (Note 5)            | \$ 1,974,524        | \$ 959,362                        | \$ 2,933,886          | \$ 4,944,348          |
| Accounts receivable                           | <u>5,010,875</u>    | <u></u>                           | <u>5,010,875</u>      | <u>5,433,404</u>      |
| <b>Total current asset</b>                    | <u>6,985,399</u>    | <u>959,362</u>                    | <u>7,944,761</u>      | <u>10,377,752</u>     |
| <b>PROPERTY AND EQUIPMENT:</b>                |                     |                                   |                       |                       |
| Construction in progress (Note 2 and 5)       | 29,592              | 3,122,034                         | 3,151,626             | 133,261               |
| Furniture and equipment (Note 2)              | 1,438,094           |                                   | 1,438,094             | 1,235,447             |
| Leasehold improvements (Note 2)               | 401,712             |                                   | 401,712               | 401,712               |
| Less: accumulated depreciation (Note 2)       | <u>(1,296,954)</u>  | <u></u>                           | <u>(1,296,954)</u>    | <u>(1,063,920)</u>    |
| <b>Net property and equipment</b>             | <u>572,444</u>      | <u>3,122,034</u>                  | <u>3,694,478</u>      | <u>706,500</u>        |
| <b>OTHER ASSETS:</b>                          |                     |                                   |                       |                       |
| Security deposits                             | <u>127,733</u>      | <u></u>                           | <u>127,733</u>        | <u>49,035</u>         |
| <b>Total other assets</b>                     | <u>127,733</u>      | <u></u>                           | <u>127,733</u>        | <u>49,035</u>         |
| <b>Total assets</b>                           | <u>\$ 7,685,576</u> | <u>4,081,396</u>                  | <u>11,766,972</u>     | <u>\$ 11,133,287</u>  |
| <b>LIABILITIES AND NET ASSETS</b>             |                     |                                   |                       |                       |
| <b>CURRENT LIABILITIES:</b>                   |                     |                                   |                       |                       |
| Accounts payable                              | \$ 2,305,800        |                                   | 2,305,800             | \$ 2,579,298          |
| Accrued payroll and related liabilities       | 302,753             |                                   | 302,753               | 173,153               |
| Advances on program revenue                   | 505,300             |                                   | 505,300               |                       |
| Loans payable-current portion (Note 4 and 6)  | <u>1,475,714</u>    | <u></u>                           | <u>1,475,714</u>      | <u>5,021,785</u>      |
| <b>Total current liabilities</b>              | <u>4,589,567</u>    | <u></u>                           | <u>4,589,567</u>      | <u>7,774,236</u>      |
| <b>LONG-TERM LIABILITIES:</b>                 |                     |                                   |                       |                       |
| Loans payable-net of current portion (Note 4) | <u>345,000</u>      | <u>2,040,698</u>                  | <u>2,385,698</u>      | <u>2,340,698</u>      |
| <b>Total long-term liabilities</b>            | <u>345,000</u>      | <u>2,040,698</u>                  | <u>2,385,698</u>      | <u>2,340,698</u>      |
| <b>Total liabilities</b>                      | <u>4,934,567</u>    | <u>2,040,698</u>                  | <u>6,975,265</u>      | <u>10,114,934</u>     |
| <b>NET ASSETS:</b>                            |                     |                                   |                       |                       |
| Unrestricted                                  | 2,751,009           |                                   | 2,751,009             | (1,022,345)           |
| Temporarily restricted (Note 5)               | <u></u>             | <u>2,040,698</u>                  | <u>2,040,698</u>      | <u>2,040,698</u>      |
| <b>Total net assets</b>                       | <u>2,751,009</u>    | <u>2,040,698</u>                  | <u>4,791,707</u>      | <u>1,018,353</u>      |
| <b>Total liabilities and net assets</b>       | <u>\$ 7,685,576</u> | <u>\$ 4,081,396</u>               | <u>\$ 11,766,972</u>  | <u>\$ 11,133,287</u>  |

The accompanying notes are an integral part of these financial statements.

**MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION****CONSOLIDATED STATEMENT OF ACTIVITIES**

For the year ended June 30, 2013

(With comparative totals for the year June 30, 2012)

|  | <u>2013</u>                | <u>2012</u>                |
|--|----------------------------|----------------------------|
| <b>REVENUES:</b>                         |                            |                            |
| Federal support                          | \$ 2,047,144               | \$ 1,510,543               |
| State support                            | 24,224,272                 | 20,788,192                 |
| Local support                            | 3,351,437                  | 1,926,163                  |
| Contributions                            | <u>1,024,633</u>           | <u>406,491</u>             |
| <b>Total revenues</b>                    | <u>30,647,486</u>          | <u>24,631,389</u>          |
| <b>EXPENSES:</b>                         |                            |                            |
| Certificated salaries                    | 11,348,116                 | 10,509,588                 |
| Classified salaries                      | 2,029,752                  | 1,964,667                  |
| Benefits                                 | 3,679,493                  | 3,289,081                  |
| Books and supplies                       | 1,758,884                  | 2,065,982                  |
| Services and other operating expenses    | 7,520,778                  | 7,533,792                  |
| Interest                                 | 276,579                    | 95,743                     |
| Depreciation                             | 233,034                    | 178,343                    |
| Capital outlay                           | 27,496                     |                            |
| Special education                        | <u>        </u>            | <u>65,363</u>              |
| <b>Total expenses</b>                    | <u>26,874,132</u>          | <u>25,702,559</u>          |
| <b>Increase (decrease) in net assets</b> | 3,773,354                  | (1,071,170)                |
| Net assets, beginning of the year        | <u>1,018,353</u>           | <u>2,089,523</u>           |
| <b>Net assets, end of the year</b>       | <u><u>\$ 4,791,707</u></u> | <u><u>\$ 1,018,353</u></u> |

The accompanying notes are an integral part of these financial statements.

**MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

For the year ended June 30, 2013

(With comparative totals for the year ended June 30, 2012)

|  | <u>2013</u>                | <u>2012</u>                |
|--|----------------------------|----------------------------|
| <b>Cash flows from operating activities:</b>   |                            |                            |
| Increase (decrease) in net assets  | \$ 3,773,354               | \$ (1,071,170)             |
| <b>Adjustments to reconcile change in net assets<br/>to net cash provided by operating activities:</b> |                            |                            |
| Depreciation   | 233,034                    | 178,343                    |
| <b>Changes in operating assets and liabilities:</b>  |                            |                            |
| (Increase) decrease in assets:   |                            |                            |
| Accounts receivable  | 422,529                    | (1,370,371)                |
| Security deposit   | (78,698)                   | (10,000)                   |
| Increase (decrease) in liabilities:  |                            |                            |
| Accounts payable   | (273,498)                  | 1,186,918                  |
| Accrued payroll and related liabilities  | <u>129,600</u>             | <u>150,899</u>             |
| <b>Net cash provided by (used in) operating activities</b>   | <u>4,206,321</u>           | <u>(935,381)</u>           |
| <b>Cash flows from investing activities:</b>   |                            |                            |
| Cash paid for the construction of building<br>and purchase of fixed assets                             | <u>(3,221,012)</u>         | <u>(228,353)</u>           |
| <b>Net cash used in investing activities</b>   | <u>(3,221,012)</u>         | <u>(228,353)</u>           |
| <b>Cash flows from financing activities:</b>   |                            |                            |
| Advances on program revenue  | 505,300                    |                            |
| Net payment on lease liabilities   |                            | (11,824)                   |
| Net proceeds from loans and lines of credit  | <u>(3,501,071)</u>         | <u>5,732,676</u>           |
| <b>Net cash (used in) provided by financing activities</b>   | <u>(2,995,771)</u>         | <u>5,720,852</u>           |
| <b>Net (decrease) increase in cash</b>   | <u>(2,010,462)</u>         | <u>4,557,118</u>           |
| Cash and cash equivalents, beginning of the year   | <u>4,944,348</u>           | <u>387,230</u>             |
| <b>Cash and cash equivalents, end of the year</b>  | \$ <u><u>2,933,886</u></u> | \$ <u><u>4,944,348</u></u> |
| <b>SUPPLEMENTAL INFORMATION:</b>   |                            |                            |
| Cash paid for interest expense   | \$ <u><u>276,579</u></u>   | \$ <u><u>95,743</u></u>    |

The accompanying notes are an integral part of these financial statements.

# **MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

### **NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **NATURE OF BUSINESS**

Magnolia Educational and Research Foundation (a California not-for-profit organization) during fiscal year ended June 30, 2013, operated twelve charter schools with grades K through twelve serving 3,647 students. The charter schools operate under the approval of the California State Board of Education and the local school districts. Each school receives public per-pupil funding to help support operations.

#### **BASIS OF ACCOUNTING**

The accompanying financial statements were prepared on the accrual basis in accordance with the AICPA's audit and accounting guide, "Not-For-Profit Organizations."

#### **ESTIMATES**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of management estimates and assumptions that could affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

#### **CASH AND CASH EQUIVALENTS**

For the purpose of the Statement of Cash Flows, Magnolia Educational and Research Foundation considers all highly liquid investments available for current use with an initial maturity of three months or less to be cash equivalents.

#### **INCOME TAXES**

Magnolia Educational and Research Foundation is a not-for-profit organization that is exempt from Federal and state income taxes under the Internal Revenue Code Section 501(c) (3) and the California State Revenue and Taxation Code 23701 (d) except on net income derived from unrelated business activities. The Organization's management believes that it has support for any tax position taken, and as such, does not have any uncertain tax positions that are material to the financial statements.

Magnolia Educational and Research Foundation's Forms 990, Return of Organization Exempt from Income Tax for the years ending June 30, 2010, 2011, 2012 and 2013 are subject to examination by the Internal Revenue Service, generally for three years after they were filed.

These notes are an integral part of the preceding financial statements.

# **MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

### **NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continud)**

#### **PROPERTY AND EQUIPMENT**

Property and equipment purchased with a value of \$5,000 or more and a life expectancy greater than two years are capitalized in the year of purchase. Property and equipment are included on the financial statements at cost less the related accumulated depreciation. The depreciation method used by Magnolia Educational and Research Foundation is straight-line over the estimated useful life of the fixed assets.

#### **COMPARATIVE FINANCIAL INFORMATION**

The financial statements include certain prior-year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the School's financial statements for the year ended June 30, 2012 from which the summarized information was derived.

#### **FINANCIAL STATEMENT PRESENTATION**

The accompanying financial statements include the consolidated activities of Magnolia Educational and Research Foundation. Magnolia Educational and Research Foundation operates the following public charter schools during fiscal year ended June 30, 2013:

- Magnolia Science Academy
- Magnolia Science Academy 2
- Magnolia Science Academy 3
- Magnolia Science Academy 4
- Magnolia Science Academy 5
- Magnolia Science Academy 6
- Magnolia Science Academy 7
- Magnolia Science Academy 8
- Magnolia Science Academy Santa Clara
- Magnolia Science Academy San Diego
- Pacific Technology School Orange vale
- Pacific Technology School Santa Ana

These notes are an integral part of the preceding financial statements.

**MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 2 - PROPERTY AND EQUIPMENT**

Below is a summary of the fixed assets owned by Magnolia Educational and Research Foundation and the schools that they operate:

| Description              | Est.<br>Life | Cost         | Accumulated<br>Depreciation | Net<br>Book Value |
|--------------------------|--------------|--------------|-----------------------------|-------------------|
| Construction in progress |              | \$ 3,151,626 |                             | \$ 3,151,626      |
| Equipment                | 5            | 1,235,447    | \$ (920,191)                | 315,256           |
| Leasehold improvements   | 10           | 401,712      | (376,763)                   | 24,949            |
| Total                    |              | \$ 4,788,785 | \$ (1,296,954)              | \$ 3,491,831      |

**NOTE 3 - ADVANCES ON PROGRAM REVENUE**

As of June 30, 2013 the schools received cash advances on per-pupil revenue projections from subsequent years from an entity independent of the California State Board of Education and local school districts. These advances were secured by, and to be repaid with, the expected receipts of these projected per-pupil revenues from State and Local sources in the subsequent year.

**NOTE 4 - LOANS PAYABLE**

Magnolia Educational and Research Foundation and the schools that they operate have the following loans outstanding as of June 30, 2013:

| Description   | Amount     |
|---|------------|
| Magnolia Science Academy 2 has an unsecured revolving loan payable to the California School Finance Authority totaling \$100,000. The loan has an annual interest rate of 0.24%. The loan repayment terms require four annual payments of \$25,000 over the next four years. The outstanding balance was \$100,000 on June 30, 2013. The maturity date is June 30, 2017.  | \$ 100,000 |
| Magnolia Science Academy 4 received an unsecured revolving loan payable to the California Department of Education totaling \$100,000 on May 25, 2010. The loan balance as of June 30, 2013 was \$40,103. The loan has an interest rate of 0.53% and it matures in five years. The repayment terms require six monthly payments each year in five fiscal years beginning on August 20, 2010. The State Controller's Office deducts the loan payments from the School's State School Fund Apportionments. | \$ 40,103  |

These notes are an integral part of the preceding financial statements.

**MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 4 - LOANS AND LINES OF CREDIT PAYABLE (continued)**

| Description   | Amount     |
|---|------------|
| Magnolia Science Academy 5 received an unsecured revolving loan payable to the California Department of Education totaling \$100,000 on May 25, 2010. The loan balance as of June 30, 2013 was \$36,688. The loan has an interest rate of 0.53% and it matures in five years. The repayment terms require six monthly payments each year in five fiscal years beginning on August 20, 2010. The State Controller's Office deducts the loan payments from the School's State School Fund Apportionments.   | \$ 36,688  |
| Magnolia Science Academy 6 received an unsecured revolving loan payable to the California Department of Education totaling \$100,000 on May 25, 2010. The loan balance as of June 30, 2013 was \$43,438. The loan has an interest rate of 0.53% and it matures in five years. The repayment terms require six monthly payments each year in five fiscal years beginning on August 20, 2010. The State Controller's Office deducts the loan payments from the School's State School Fund Apportionments.   | \$ 43,438  |
| Facilitated by the California School Finance Authority, Magnolia Science Academy 8 received loan amounts from a local financing company for an accumulated total of \$826,500 during the fiscal year. The loan balance as of June 30, 2013 was \$336,282. The loan has an annual interest rate of 5%. The loan is secured by anticipated State funding that was deferred due to the State budget crisis, and it will be repaid by State revenue directly to the local financing company when the funds are disbursed from the State. The full balance was paid off on August 28, 2013 (Note 6.) | \$ 336,282 |

These notes are an integral part of the preceding financial statements.

**MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 4 - LOANS AND LINES OF CREDIT PAYABLE (continued)**

| Description  | Amount     |
|--|------------|
| Facilitated by the California School Finance Authority, Magnolia Science Academy Santa Clara received loan amounts from a local financing company for an accumulated total of \$444,200 during the fiscal year. The loan balance as of June 30, 2013 was \$444,200. The loan has an annual interest rate of 5%. The loan is secured by anticipated State funding that was deferred due to the State budget crisis, and it will be repaid by State revenue directly to the local financing company when the funds are disbursed from the State. The full balance was paid off on September 20, 2013 (Note 6.) | \$ 444,200 |
| Magnolia Science Academy San Diego received an unsecured revolving loan payable to the California Department of Education totaling \$100,000 on June 23, 2010. The loan balance as of June 30, 2013 was \$40,000. The loan has an interest rate of 0.54% and it matures in five years. The repayment terms require six monthly payments each year in five fiscal years beginning on August 20, 2010. The State Controller's Office deducts the loan payments from the School's State School Fund Apportionments.   | \$ 40,000  |
| Facilitated by the California School Finance Authority, Pacific Technology School Orangevale received loan amounts from a local financing company for an accumulated total of \$223,600 during the fiscal year. The loan balance as of June 30, 2013 was \$223,600. The loan has an annual interest rate of 5%. The loan is secured by anticipated State funding that was deferred due to the State budget crisis, and it will be repaid by State revenue directly to the financing company when the funds are disbursed from the State. The full balance was paid off in October, 2013 (Note 6.)            | \$ 223,600 |
| Pacific Technology School Orangevale received an unsecured revolving loan payable to the California Department of Education totaling \$250,000 on March 23, 2010. The loan balance as of June 30, 2013 was \$108,334. The loan has an interest rate of 0.53% and it matures in five years. The repayment terms require six monthly payments each year in five fiscal years beginning on August 20, 2010. The State Controller's Office deducts the loan payments from the School's State School Fund Apportionments.   | \$ 108,334 |

These notes are an integral part of the preceding financial statements.



**MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 4 - LOANS AND LINES OF CREDIT PAYABLE (continued)**

| Description   | Amount     |
|---|------------|
| Facilitated by the California School Finance Authority, Pacific Technology School Santa Ana received loan amounts from a local financing company for an accumulated total of \$261,400 during the fiscal year. The loan balance as of June 30, 2013 was \$261,400. The loan has an annual interest rate of 5%. The loan is secured by anticipated State funding that was deferred due to the State budget crisis, and it will be repaid by State revenue directly to the local financing company when the funds are disbursed from the State. The full balance was paid off on October 16, 2013 (Note 6.) | \$ 261,400 |
| Pacific Technology School Santa Ana received an unsecured revolving loan payable to the California Department of Education totaling \$100,000 on May 25, 2010. The loan balance as of June 30, 2013 was \$36,669. The loan has an interest rate of 0.53% and it matures in five years. The repayment terms require six monthly payments each year in five fiscal years beginning on August 20, 2010. The State Controller's Office deducts the loan payments from the School's State School Fund Apportionments.  | \$ 36,669  |
| Pacific Technology School Santa Ana received another unsecured revolving loan payable to the California Department of Education totaling \$150,000 on November 30, 2012. The loan balance as of June 30, 2013 was \$150,000. The loan has an interest rate of 0.53% and it matures in five years. The repayment terms require six monthly payments each year in five fiscal years beginning on October 30, 2013. The State Controller's Office deducts the loan payments from the School's State School Fund Apportionments.  | \$ 150,000 |

These notes are an integral part of the preceding financial statements.

**MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 4 - LOANS AND LINES OF CREDIT PAYABLE (continued)**

| Description   | Amount       |
|---|--------------|
| Pacific Technology School Santa Ana was approved for a loan of \$8,706,978 from California School Finance Authority for the land acquisition and construction of a new school facility. The School received \$2,040,698 in the year ended June 30, 2012. The outstanding loan balance as of June 30, 2013 was \$2,040,698. The loan has an annual interest rate of 3% and it matures in 30 years after the completion of the project, which is estimated to be in the middle of calendar year 2014. The repayment schedule will be determined after completion of the project. The State Controller's Office will deduct the loan payments from the School's State School Fund Apportionments (Note 5.) | \$ 2,040,698 |
| Total   | 3,861,412    |
| Less current portion  | 1,475,714    |
| Long-term portion   | \$ 2,385,698 |

Principal maturities for the outstanding loans are listed as follows:

| For the year ended June 30, | Amount       |
|-----------------------------|--------------|
| 2014                        | \$ 1,475,714 |
| 2015                        | 205,000      |
| 2016                        | 55,000       |
| 2017                        | 55,000       |
| 2018                        | 30,000       |
| Thereafter                  | 2,040,698    |
| Total                       | \$ 3,861,412 |

These notes are an integral part of the preceding financial statements.

**MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 5 - TEMPORARILY RESTRICTED NET ASSETS**

Pacific Technology School Santa Ana has been approved from the State of California's Charter School Facilities Program for \$17,413,956 for constructing a new facility which will cost the same amount. The State will fund 50% of the total amount of \$17,413,956 through a grant in the amount of \$8,706,978; the State will fund another 50% of the total project cost through a loan in the amount of \$8,706,978. As of June 30, 2013, the School has received total amount of \$4,081,396, of which \$2,040,698 was loan, and \$2,040,698 was grant. The grant portion of the amount is classified as temporarily restricted net assets until the fund is used for the purchase of the land and the construction of the facility.

**NOTE 6 - SUBSEQUENT EVENT**

The School's Management has evaluated subsequent events for the period from June 30, 2013 through October 21, 2013, the date the financial statements were available to be issued. Management identified the following transactions that require disclosure or that would have an impact on the financial statements.

Loans mentioned in note 4 with the amount of \$1,265,485 were paid off by October 21, 2013.

These notes are an integral part of the preceding financial statements.

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**Magnolia Science Academy**  
**Balance Sheet**  
As of March 31, 2014

|  | <u>Mar 31, 14</u>          |
|--|----------------------------|
| <b>ASSETS</b>                          |                            |
| <b>Current Assets</b>                  |                            |
| Checking/Savings                       |                            |
| 101 · Checking Account                 | 1,256,639.96               |
| 104 · Debit Card                       | 2,630.77                   |
| <b>Total Checking/Savings</b>          | <u>1,259,270.73</u>        |
| Accounts Receivable                    |                            |
| 111 · Accounts Receivable              | 399,576.69                 |
| <b>Total Accounts Receivable</b>       | <u>399,576.69</u>          |
| Other Current Assets                   |                            |
| 112 · Prepaid Expenses                 | 97,506.89                  |
| 114 · Security Deposit                 | 39,035.00                  |
| <b>Total Other Current Assets</b>      | <u>136,541.89</u>          |
| <b>Total Current Assets</b>            | <u>1,795,389.31</u>        |
| <b>Fixed Assets</b>                    |                            |
| 115 · Fixed Assets                     |                            |
| Accumu. Depreciation                   | -579,655.75                |
| Leasehold improvements                 | 374,817.75                 |
| 115A · Software                        | 6,288.66                   |
| 115B · IT Equipment                    | 71,001.77                  |
| 115C · Furniture                       | 206,577.00                 |
| <b>Total 115 · Fixed Assets</b>        | <u>79,029.43</u>           |
| <b>Total Fixed Assets</b>              | <u>79,029.43</u>           |
| <b>TOTAL ASSETS</b>                    | <u><u>1,874,418.74</u></u> |
| <b>LIABILITIES &amp; EQUITY</b>        |                            |
| <b>Liabilities</b>                     |                            |
| <b>Current Liabilities</b>             |                            |
| Accounts Payable                       |                            |
| 201 · Accounts Payable                 | 2,500.01                   |
| <b>Total Accounts Payable</b>          | <u>2,500.01</u>            |
| Other Current Liabilities              |                            |
| 204 · Payroll Clearing Account         | 39,492.53                  |
| 205 · Retirement Plan Liability        | 17,037.00                  |
| <b>Total Other Current Liabilities</b> | <u>56,529.53</u>           |
| <b>Total Current Liabilities</b>       | <u>59,029.54</u>           |
| <b>Total Liabilities</b>               | <u>59,029.54</u>           |
| <b>Equity</b>                          |                            |
| 301 · Retained Earnings                | 1,415,788.64               |
| Net Income                             | 399,600.56                 |
| <b>Total Equity</b>                    | <u>1,815,389.20</u>        |
| <b>TOTAL LIABILITIES &amp; EQUITY</b>  | <u><u>1,874,418.74</u></u> |

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**Magnolia Science Academy**  
**Profit & Loss**  
 July 1 2013 through March 31 2014

|   | <u>Jul '13 - Mar 14</u> |
|---|-------------------------|
| Ordinary Income/Expense                 |                         |
| Income                                  |                         |
| 8000 · REVENUES                         |                         |
| 1 · Principal Apportionment             |                         |
| 8012 · Education Protection Account     | 409,037.00              |
| 8015 · Gen. Purp. Entitlmnt-State Aid   | 1,264,558.00            |
| 8019 · State Aid-PY adjustments         | -58,000.00              |
| 8096 · Funding In Lieu of Prop Tax-CY   | 600,325.77              |
| Total 1 · Principal Apportionment       | <u>2,215,920.77</u>     |
| 2 · Federal Revenues                    |                         |
| 8181 · Special Ed. IDEA                 | 74,890.17               |
| 8220 · Child Nutrition-Federal          | 132,034.89              |
| 8290 · NCLB(including ARRA)             | 104,902.00              |
| Total 2 · Federal Revenues              | <u>311,827.06</u>       |
| 3 · Other State Revenue                 |                         |
| 8311 · Special Education AB 602         | 212,424.28              |
| 8520 · Child Nutrition - State          | 12,752.51               |
| 8560 · State Lottery                    | 16,381.67               |
| 8590 · All other State Revenues         |                         |
| Economic Impact Aid                     | 111,528.00              |
| Categorical Block Grant                 | 150,835.00              |
| 8590 · All other State Revenues - Other | 397,452.18              |
| Total 8590 · All other State Revenues   | <u>659,815.18</u>       |
| Total 3 · Other State Revenue           | 901,373.64              |
| 4 · Local Revenue                       |                         |
| 8610 · Donations                        | 417.65                  |
| 8615 · Fundraising                      | 45,624.03               |
| 8620 · Grants                           | 12,626.00               |
| 8634 · Food Service Sales               | 4,130.00                |
| 8699 · Other Local Revenues             | 28,222.50               |
| Total 4 · Local Revenue                 | <u>91,020.18</u>        |
| Total 8000 · REVENUES                   | <u>3,520,141.65</u>     |
| Total Income                            | <u>3,520,141.65</u>     |
| Gross Profit                            | 3,520,141.65            |
| Expense                                 |                         |
| EXPENDITURES                            |                         |
| 1000 · Certificated Salaries            |                         |

**Magnolia Science Academy**  
**Profit & Loss**  
 July 1 2013 through March 31 2014

|  | <b>Jul '13 - Mar 14</b> |
|--|-------------------------|
| <b>1100 · Teacher Salaries</b>                   | 1,002,097.68            |
| <b>1300 · Principal &amp; School Admin</b>       | 178,261.94              |
| <b>Total 1000 · Certificated Salaries</b>        | 1,180,359.62            |
| <br><b>2000 · Classified Salaries</b>            |                         |
| <b>2400 · Clerical &amp; Office Staff</b>        | 155,620.23              |
| <b>2900 · Other Classified Salaries</b>          | 63,913.67               |
| <b>Total 2000 · Classified Salaries</b>          | 219,533.90              |
| <br><b>3000 · Employee Benefits</b>              |                         |
| <b>3101 · STRS</b>                               | 88,945.22               |
| <b>3201 · PERS</b>                               | 16,855.91               |
| <b>3301 · OASDI/Medicare/Alternative</b>         |                         |
| <b>3301A · OASDI</b>                             | 76.26                   |
| <b>3301B · MEDICARE</b>                          | 221.15                  |
| <b>3301 · OASDI/Medicare/Alternative - Other</b> | 35,636.94               |
| <b>Total 3301 · OASDI/Medicare/Alternative</b>   | 35,934.35               |
| <br><b>3401 · Health &amp; Welfare Benefits</b>  | 158,862.08              |
| <b>3501 · Unemployment Insurance</b>             | 23,357.43               |
| <b>3601 · Workers Compensation</b>               | 21,091.39               |
| <b>3901 · Other Employee Benefits</b>            | 36.90                   |
| <b>Total 3000 · Employee Benefits</b>            | 345,083.28              |
| <br><b>4000 · Books &amp; Supplies</b>           |                         |
| <b>4100 · Textbooks</b>                          | 28,737.54               |
| <b>4200 · Books Other Than Textbooks</b>         | 27,879.55               |
| <b>4300 · Materials and Supplies</b>             |                         |
| <b>4310 · Office &amp; Classroom Supplies</b>    | 24,846.43               |
| <b>4320 · IT Materials &amp; Softwares</b>       | 8,734.64                |
| <b>4340 · Science Lab Supplies</b>               | 4,327.68                |
| <b>4390 · Other Supplies</b>                     | 60,414.17               |
| <b>4300 · Materials and Supplies - Other</b>     | 23.42                   |
| <b>Total 4300 · Materials and Supplies</b>       | 98,346.34               |
| <br><b>4700 · Food Service Supplies</b>          | 166,534.12              |
| <b>4000 · Books &amp; Supplies - Other</b>       | 193.90                  |
| <b>Total 4000 · Books &amp; Supplies</b>         | 321,691.45              |
| <br><b>5000 · Services,Other Operating Exp</b>   |                         |
| <b>5200 · Travel &amp; Confrences</b>            | 3,530.84                |
| <b>5300 · Dues &amp; Memberships</b>             | 3,935.32                |
| <b>5400 · Liability Insurance</b>                | 31,514.33               |
| <b>5500 · Operations &amp; Housekeeping Serv</b> |                         |
| <b>5510 · Utilities</b>                          | 43,329.44               |



**Magnolia Science Academy**  
**Profit & Loss**  
July 1 2013 through March 31 2014

|   | <b>Jul '13 - Mar 14</b> |
|---|-------------------------|
| 5520 · Maintenance                                      | 3,031.54                |
| <b>Total 5500 · Operations &amp; Housekeeping Serv</b>  | <b>46,360.98</b>        |
| <br>5600 · Rentals/Leases/Repairs&Noncapit              |                         |
| 5610 · Building Rent                                    | 376,474.32              |
| 5620 · Building Repairs                                 | 3,402.00                |
| 5630 · Equipment Leases                                 | 20,486.08               |
| 5600 · Rentals/Leases/Repairs&Noncapit - Other          | 109.10                  |
| <b>Total 5600 · Rentals/Leases/Repairs&amp;Noncapit</b> | <b>400,471.50</b>       |
| <br>5800 · Consulting Ser.& Operating Exp.              |                         |
| 5810 · CMO Fees   | 292,520.66              |
| 5815 · Attorney & Legal Fees                            | 7,462.42                |
| 5820 · District/County Oversight Fee                    | 23,643.75               |
| 5830 · Professional Consulting Service                  | 19,975.80               |
| 5840 · School Programs                                  |                         |
| 5842 · Academic Competitions                            | 1,108.18                |
| 5843 · Field Trips & Transportation                     | 6,421.89                |
| 5849 · Other School Programs                            | 11,210.14               |
| <b>Total 5840 · School Programs</b>                     | <b>18,740.21</b>        |
| <br>5850 · Advertisement                                | 1,075.00                |
| 5855 · Professional Development                         | 6,205.53                |
| 5860 · Special Education Cost                           |                         |
| 5861 · Fair Share Contribution                          | 51,681.83               |
| 5860 · Special Education Cost - Other                   | 50,324.00               |
| <b>Total 5860 · Special Education Cost</b>              | <b>102,005.83</b>       |
| <br>5875 · Bank Charges                                 | 1,007.98                |
| 5885 · IT Services                                      | 15,744.77               |
| 5890 · Substitute Teacher                               | 8,093.64                |
| 5899 · Other Professional Services                      | 52,531.04               |
| <b>Total 5800 · Consulting Ser.&amp; Operating Exp.</b> | <b>549,006.63</b>       |
| <br>5900 · Communications                               | 10,668.92               |
| 5000 · Services,Other Operating Exp - Other             | 85.32                   |
| <b>Total 5000 · Services,Other Operating Exp</b>        | <b>1,045,573.84</b>     |
| <br>6000 · Capital Outlay                               |                         |
| 6200 · Building&Imprvmnts of Buildings                  | 8,299.00                |
| <b>Total 6000 · Capital Outlay</b>                      | <b>8,299.00</b>         |
| <br><b>Total EXPENDITURES</b>                           | <b>3,120,541.09</b>     |
| <br><b>Total Expense</b>                                | <b>3,120,541.09</b>     |

**Magnolia Science Academy**  
**Profit & Loss**  
July 1 2013 through March 31 2014

**Jul '13 - Mar 14**

**Net Ordinary Income**

**399,600.56**

**Net Income**

**399,600.56**

**MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION**  
**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**  
At March 31 2014

|                                       | <b>As of March 31<br/>2014</b> |
|---------------------------------------|--------------------------------|
| <b>ASSETS</b>                         |                                |
| <b>Current Assets</b>                 |                                |
| Checking/Savings                      | 5,032,572                      |
| Accounts Receivable                   | 1,738,041                      |
| Other Current Assets                  | 876,106                        |
| <b>Total Current Assets</b>           | <b>7,646,719</b>               |
| <b>Fixed Assets</b>                   | <b>4,123,674</b>               |
| <b>TOTAL ASSETS</b>                   | <b>11,770,393</b>              |
| <b>LIABILITIES &amp; EQUITY</b>       |                                |
| <b>Liabilities</b>                    |                                |
| <b>Current Liabilities</b>            |                                |
| Accounts Payable                      | 777,751                        |
| Other Current Liabilities             | 3,419,550                      |
| <b>Total Current Liabilities</b>      | <b>4,197,300</b>               |
| <b>Total Liabilities</b>              | <b>4,197,300</b>               |
| <b>Equity</b>                         | <b>7,573,093</b>               |
| <b>TOTAL LIABILITIES &amp; EQUITY</b> | <b>11,770,393</b>              |

**MAGNOLIA EDUCATIONAL AND RESEARCH FOUNDATION**

**CONSOLIDATED STATEMENT OF ACTIVITIES**

July 1 2013 through March 31 2014

|                                       | <u>July 1 2013-March 31 2014</u> |
|---------------------------------------|----------------------------------|
| <b>REVENUES:</b>                      |                                  |
| Federal support                       | 1,502,065                        |
| State support                         | 14,425,893                       |
| Local support                         | 5,509,782                        |
| Other Revenues                        | <u>799,201</u>                   |
| <b>Total revenues</b>                 | <u><b>22,236,939</b></u>         |
| <b>EXPENSES:</b>                      |                                  |
| Certificated salaries                 | 8,500,164                        |
| Classified salaries                   | 1,618,452                        |
| Benefits                              | 2,466,536                        |
| Books and supplies                    | 1,995,532                        |
| Services and other operating expenses | 4,874,870                        |
| Depreciation                          | 0                                |
| <b>Total expenses</b>                 | <u><b>19,455,554</b></u>         |
| <b>Net Income</b>                     | <b>2,781,386</b>                 |

## **APPENDIX C**

### **SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL BOND DOCUMENTS**

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## APPENDIX C

### SUMMARY OF CERTAIN PROVISIONS OF THE PRINCIPAL BOND DOCUMENTS

*The following is a summary of certain provisions of the Indenture, the Loan Agreement, the Deed of Trust and the Lease which are not described elsewhere in this Limited Offering Memorandum. **These summaries do not purport to be complete or definitive and reference should be made to such documents for a full and complete statement of their provisions.** All capitalized terms used with respect to the Bonds and not defined in this Limited Offering Memorandum have the meanings set forth in the Indenture.*

### DEFINITIONS

The following are definitions of certain terms used in the Indenture and the Loan Agreement applicable to the Bonds.

“Accountant” means any firm of independent certified public accountants selected by the Borrower.

“Act” means the California School Finance Authority Act, constituting Chapter 18 (commencing with Section 17170) of Part 10 of Division 1 of Title 1 of the Education Code of the State, as now in effect and as it may from time to time hereafter be amended or supplemented.

“Additional Bonds” means all revenue bonds of the Authority, other than the 2014A Bonds and the 2014B Bonds, authorized by and at any time Outstanding pursuant hereto and executed, issued and delivered in accordance with the Indenture.

“Additional Payments” shall have the meaning given thereto in the Loan Agreement.

“Administrative Fees and Expenses” means any application, commitment, financing or similar fee charged, or reimbursement for administrative or other expenses incurred, by the Authority or the Trustee in connection with the Bonds, including Additional Payments.

“Approved Institutional Buyer” shall have the meaning given to a “qualified institutional buyer” under Rule 144A of the Securities Act of 1933.

“Authority” means the California School Finance Authority, a public instrumentality of the State established by the act, and its successors and assigns.

“Authorized Borrower Representative” means any person who at the time and from time to time may be designated, by written certificate furnished to the Authority and the Trustee, as a person authorized to act on behalf of the Borrower. Such certificate shall contain the specimen signature of such person, shall be signed on behalf of the Borrower by any officer of the Borrower and may designate an alternate or alternates.

“Authorized Denominations” means (i) with respect to the 2014A Bonds and the 2014B Bonds, \$100,000 and any integral multiple of \$5,000 in excess thereof and (ii) in the case of Additional Bonds, the amount specified in the Supplemental Indenture authorizing the issuance thereof.

“Authorized Signatory” means any member of the Authority and any other person as may be designated and authorized to sign on behalf of the Authority pursuant to a resolution adopted thereby.

“Beneficial Owner” means, (i) when used with reference to the Book Entry Only System, the person who is considered the beneficial owner of the Bonds and, with respect to the Bonds pursuant to the arrangements for book entry determination of ownership applicable to the Depository and, (ii) for purposes of the provisions of the Indenture relating to continuing disclosure, any person who (a) has the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, any Bonds and, with respect to the Bonds (including persons holding such through nominees, depositories or other intermediaries) or (b) is treated as the owner of any Bonds and, with respect to the Bonds for federal income tax purposes.

“Bondholder” or “Holder” means, with respect to any Bond, the person in whose name such Bond is registered.

“Bond Purchase Agreement” means and refers to that certain Bond Purchase Agreement, dated June 18, 2014, among the Authority, the Underwriter, and the State Treasurer, as agent for sale, and approved by the Lessee.

“Bond Reserve Subaccount” means the Bond Reserve Subaccount of the Reserve Account established by the Trustee pursuant to the Indenture.

“Bond Year” means the period beginning on the Closing Date and ending on the first anniversary of the Closing Date and each succeeding one-year period (with the last Bond Year ending on the first date that none of the Bonds remain Outstanding).

“Bonds” means, collectively, the 2014A Bonds and the 2014B Bonds and any Additional Bonds authorized by and at any time Outstanding pursuant to the Indenture.

“Book Value” means, when used in connection with Property of a Person, the value of such Property, net of accumulated depreciation, as it is carried on the books of such Person and in conformity with generally accepted accounting principles.

“Borrower” means MPM Sherman Way LLC, a California limited liability company, whose sole member is the Sole Member, its successors and assigns.

“Borrower Documents” means the Loan Agreement, the Bond Purchase Agreement, the Lease and the Deed of Trust.

“Borrower Resolution” means the resolution or other authorizing action adopted by the Sole Member on behalf of the Borrower authorizing the Loan and execution and delivery of the Borrower Documents.

“Business Day” means any day other than a Saturday, a Sunday or a day on which banking institutions in the city in which the Principal Corporate Trust Office is located are authorized or obligated by law or executive order to be closed.

“Certificate of the Authority,” “Consent of the Authority,” “Order of the Authority,” “Request of the Authority” or “Requisition of the Authority” mean, respectively, a written certificate, consent, order, request or requisition of the Authority signed by or on behalf of the Authority by an Authorized Signatory authorized by the Authority to execute such a document on its behalf.

“Certificate of the Borrower,” “Consent of the Borrower,” “Request of the Borrower,” “Requisition of the Borrower” or “Statement of the Borrower” mean, respectively, a written certificate,



request, requisition or statement of the Borrower executed on its behalf by the Sole Member's Chief Financial Officer, President or such other person as may be designated by any of such officials to sign for the Borrower.

"Charter School Law" means the Charter Schools Act of 1992, constituting Part 26.8, commencing with Section 47600, of Division 4 of Title 2 of the Education Code of the State, as now in effect and as it may from time to time hereafter be amended or supplemented.

"Closing Date" shall mean June 26, 2014, the date of original issuance and delivery of the Bonds.

"Code" means the Internal Revenue Code of 1986, or any successor code or law, and any regulations in effect or promulgated thereunder.

"Completion" means satisfaction of all of the conditions to completion of the Project as described in the Loan Agreement including delivery of the Completion Certificate pursuant to the Loan Agreement.

"Completion Certificate" means Completion Certificate substantially in a form as provided in the Loan Agreement.

"Continuing Disclosure Agreement" means the Continuing Disclosure Agreement, dated as of June 1, 2014, among the Lessee, the Borrower and the Trustee, as dissemination agent, as originally executed and as it may be amended from time to time in accordance with the terms thereof.

"Controller" means the office of the Controller of the State of California.

"Costs of Issuance" means all items of expense directly or indirectly payable by or reimbursable to the Authority or the Borrower and related to the original authorization, execution, sale and delivery of the Bonds, including but not limited to costs of preparation and reproduction of documents, fees and expenses of the Authority, the State Treasurer's Office, the Trustee, legal fees and charges of bond counsel, special counsel, disclosure counsel and Trustee's counsel, underwriters' discount, rating agency fees and any other costs, charges or fees in connection with the original delivery of the Bonds.

"Costs of Issuance Fund" means the fund by that name established pursuant to the Indenture.

"Debt Service" means, for any period of time, the sum of (a) the interest payable during such period on all Outstanding Bonds, (b) that portion of the principal amount of all Outstanding Bonds maturing on each principal payment date during such period, and (c) that portion of the principal amount of all Outstanding Bonds which are Term Bonds required to be redeemed or paid from Sinking Fund Installments during such period (together with the redemption premiums, if any, thereon).

"Debt Service Coverage Ratio" shall have the meaning given thereto and shall be calculated as set forth in the Lease.

"Deed of Trust" means that certain Deed of Trust with Assignment of Rents, Security Agreement and Fixture Filing, dated as of June 1, 2014, executed as a counterpart to the Deed of Trust by the Borrower, as trustor, in favor of the Title Company, as deed of trust trustee thereunder, creating a lien on the Facility located in the County of Los Angeles that Borrower owns in fee for the benefit of the Trustee (as assignee of the Authority), as trustee for the benefit of the Holders of the Bonds.

“Depository” means The Depository Trust Company and its successors and assigns, or any other depository selected as set forth in the Indenture which agrees to follow the procedures required to be followed by such depository in connection with the Bonds.

“Direct Costs” means the costs of the land, the improvements, the personal property, and all labor, materials, fixtures, machinery and equipment required to acquire, construct, equip and complete the construction and improvements to the Facility.

“Education Code” means the Education Code of the State of California.

“Electronic Notice” means notice through telecopy, telegraph, telex, facsimile, transmission, internet, e-mail or other electronic means of communication, capable of making a written record.

“Eligible Securities” means any of the following obligations as and to the extent that such obligations are at the time legal investments under the Act for moneys held under the Indenture and then proposed to be invested therein (provided that the Trustee shall be entitled to rely upon a Request of the Borrower as conclusive evidence that the investments described therein are so authorized under the laws of the State) and shall be the sole investments in which amounts on deposit in any fund or account created under the Indenture or under the Loan Agreement shall be invested:

(1) direct obligations of the United States of America (including obligations issued or held in book-entry form on the books of the Department of the Treasury of the United States of America or any Federal Reserve Bank and CATS and TIGRS) or obligations the timely payment of the principal of and interest on which are fully and unconditionally guaranteed by the United States of America;

(2) Bonds, debentures, notes or other evidence of indebtedness issued or guaranteed by any of the following federal agencies, provided that such obligations are backed by the full faith and credit of the United States of America (stripped securities shall constitute Eligible Securities only if they have been stripped by the agency itself); U.S. Export-Import Bank, Farmers Home Administration, Federal Financing Bank, General Services Administration, U.S. Maritime Administration, U.S. Department of Housing and Urban Development, Government National Mortgage Association, and Federal Housing Administration;

(3) Bonds, debentures, notes, or other evidence of indebtedness issued or guaranteed by any of the following non-full faith and credit U.S. government agencies (stripped securities shall constitute Eligible Securities only if they have been stripped by the agency itself): Federal Home Loan Bank System, Federal Home Loan Mortgage Corporation (“FHLMC”), Federal National Mortgage Association (“FNMA”), Student Loan Marketing Association, Resolution Funding Corporation or Farm Credit System;

(4) Bonds or notes issued by any state or municipality which are rated by S&P, Fitch and Moody’s in one of the three highest rating categories assigned by such agencies;

(5) repurchase agreements with either a primary dealer on the reporting dealer list of the Federal Reserve or any bank (including an affiliate of the Trustee), which, in either case, is rated “A” or better by S&P and Moody’s, provided that (a) the term of such repurchase agreement is not greater than thirty days, (b) the Trustee or third party acting solely as agent for the Trustee has possession of the collateral, (c) the collateral is valued weekly and the market value of the collateral is maintained at an amount equal to at least 104% (or, if the collateral consists of obligations of FHLMC or FNMA, 105%) of the amount of cash transferred by the Trustee to the dealer bank or securities firm under the repurchase

agreement plus interest, (d) failure to maintain the requisite collateral levels will require the Trustee to liquidate the collateral immediately, (e) the repurchase securities are either obligations of, or fully guaranteed as to principal and interest by, the United States or any federal agency backed by the full faith and credit of the United States; (f) the repurchase securities are free and clear of any third-party lien or claim; and (g) there shall have been delivered to the Trustee, the Authority and the Borrower an Opinion of Counsel to the effect that such repurchase agreement meets all guidelines under State law for legal investment of public funds;

(6) investment agreements, including guaranteed investment contracts (“GICs”) with providers in one of the two highest rating categories of Moody’s and S&P;

(7) money market funds registered under the Federal Investment Company Act of 1940, whose shares are registered under the Federal Securities Act of 1933, and having a rating by S&P of “AAAm-G”, “AAA-m” or “AA-m” and if rated by Moody’s rated “Aaa”, “Aa1” or “Aa2”, including such funds for which the Trustee, its affiliates or subsidiaries provide investment advisory or other management services or for which the Trustee or an affiliate of the Trustee serves as investment administrator, shareholder servicing agent, and/or custodian or subcustodian, notwithstanding that (i) the Trustee or an affiliate of the Trustee receives fees from funds for services rendered, (ii) the Trustee collects fees for services rendered pursuant to the Indenture, which fees are separate from the fees received from such funds, and (iii) services performed for such funds and pursuant to the Indenture may at times duplicate those provided to such funds by the Trustee or an affiliate of the Trustee;

(8) certificates of deposit secured at all times by collateral described in (1) and/or (2) above, issued by commercial banks, savings and loan associations or mutual savings banks relating to collateral held by a third party, and in which collateral the Trustee on behalf of the Bondholders has a perfected first security interest;

(9) certificates of deposit, savings accounts, deposit accounts or money market deposits that are fully insured by FDIC, including BIF and SAIF;

(10) commercial paper rated, at the time of purchase, “Prime-1” by Moody’s and “A-1” or better by S&P;

(11) federal funds or bankers acceptances with a maximum term of one year of any bank which has an unsecured, uninsured and unguaranteed obligation rating of “Prime-1” or “A-3” or better by Moody’s and “A-1” or “A” or better by S&P;

(12) shares in a California common law trust established pursuant to Title 1, Division 7, Chapter 5 of the Government Code of the State which invests exclusively in investments permitted by Section 53635 of Title 5, Division 2, Chapter 4 of the Government Code of the State as it may be amended;

(13) the State of California’s Pooled Money Investment Account;

(14) the State of California’s Local Agency Investment Fund; and

(15) obligations of a bank or other financial institution rated at least “Aa3” by Moody’s or “AA-” by S&P.

“Environmental Regulations” means any federal, state or local law, statute, code, ordinance, regulation, requirement or rule relating to dangerous, toxic or hazardous pollutants, Hazardous Substances or chemical waste, materials or substances.

“Event of Default” means any of the events specified in the Indenture.

“Facility” means all of the real property at 18238 Sherman Way, Reseda, California described further in the Lease, together with the improvements thereof.

“Fiscal Year” means, with respect to the Borrower, the twelve month period beginning July 1 and ending on June 30, or such other twelve month period as may be designated in a written Statement of the Borrower delivered to the Authority and the Trustee.

“Fitch” means Fitch Ratings, Inc., a corporation organized and existing under the laws of the State of Delaware, its successors and assigns, or, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, any other nationally recognized securities rating agency designated by the Authority.

“Government Obligations” means noncallable and nonprepayable direct obligations of the United States of America or obligations which as to full and timely payment of principal and interest constitute full faith and credit obligations of the United States of America (excluding therefrom unit investment trusts and money market funds comprised of such securities).

“Grant-Funded Reserve Eligible Securities” means:

- (1) obligations issued or guaranteed by the United States Government;
- (2) obligations of agencies or instrumentalities of the United States, including government-sponsored enterprises;
- (3) obligations issued by or guaranteed by any state, provided such obligations are rated in the two highest rating categories of Moody’s, S&P or Fitch;
- (4) commercial paper, repurchase agreements, guaranteed investment contracts or other similar instruments issued by corporations that are organized and operating within the United States having assets in excess of \$500 million and having a short-term rating in the highest rating category of Moody’s, S&P or Fitch Ratings, and a long-term rating in one of the two highest rating categories;
- (5) money market funds that invest solely in United States Government securities or obligations of agencies or instrumentalities of the United States, including such funds for which the Trustee, its affiliates or subsidiaries provide investment advisory or other management services or for which the Trustee or an affiliate of the Trustee serves as investment administrator, shareholder servicing agent, and/or custodian or subcustodian, notwithstanding that (i) the Trustee or an affiliate of the Trustee receives fees from funds for services rendered, (ii) the Trustee collects fees for services rendered pursuant to the Indenture, which fees are separate from the fees received from such funds, and (iii) services performed for such funds and pursuant to the Indenture may at times duplicate those provided to such funds by the Trustee or an affiliate of the Trustee;
- (6) money market fund deposits or certificates of deposit made in federally insured, regulated credit unions or banks, to the extent fully insured or collateralized with investments under categories (1) through (5), including such funds for which the Trustee, its affiliates or subsidiaries provide

investment advisory or other management services or for which the Trustee or an affiliate of the Trustee serves as investment administrator, shareholder servicing agent, and/or custodian or subcustodian, notwithstanding that (i) the Trustee or an affiliate of the Trustee receives fees from funds for services rendered, (ii) the Trustee collects fees for services rendered pursuant to the Indenture, which fees are separate from the fees received from such funds, and (iii) services performed for such funds and pursuant to the Indenture may at times duplicate those provided to such funds by the Trustee or an affiliate of the Trustee; and

(7) such other investment securities as the U.S. Secretary of Education may determine are prudent investments that comply with applicable law and regulations.

“Grant-Funded Reserve Fund Agreement” means the Debt Service Reserve Fund Agreement, dated as of June 1, 2014, by and between the Authority and the Borrower.

“Grant-Funded Reserve Subaccount” means the Reserve Subaccount of the Reserve Account established by the Trustee pursuant to the Indenture.

“Gross Revenues” means, for any Fiscal Year, all of the revenues, income, cash receipts and other money received by the Borrower, or received by the Trustee on behalf of the Borrower pursuant to the Indenture, that are legally available for payment of the obligations of the Borrower under the Loan Agreement.

“Hazardous Substances” means (a) any oil, flammable substance, explosives, radioactive materials, hazardous wastes or substances, toxic wastes or substances or any other wastes, materials or pollutants which (i) pose a hazard to the Project or to persons on or about the Project or (ii) cause the Project to be in violation of any Environmental Regulation; (b) asbestos in any form which is or could become friable, urea formaldehyde foam insulation, transformers or other equipment which contain dielectric fluid containing levels of polychlorinated biphenyls, or radon gas; (c) any chemical, material or substance defined as or included in the definition of “waste,” “hazardous substances,” “hazardous wastes,” “hazardous materials,” “extremely hazardous waste,” “restricted hazardous waste,” or “toxic substances” or words of similar import under any Environmental Regulation including, but not limited to, the Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”), 42 USC §§ 9601 et seq.; the Resource Conservation and Recovery Act (“RCRA”), 42 USC §§ 6901 et seq.; the Hazardous Materials Transportation Act, 49 USC §§ 1801 et seq.; the Federal Water Pollution Control Act, 33 USC §§ 1251 et seq.; the California Hazardous Waste Control Law (“HWCL”), Cal. Health & Safety Code §§ 25100 et seq.; the Hazardous Substance Account Act (“HSAA”), Cal. Health & Safety Code §§ 25300 et seq.; the Underground Storage of Hazardous Substances Act, Cal. Health & Safety Code §§ 25280 et seq.; the Porter-Cologne Water Quality Control Act (the “Porter-Cologne Act”), Cal. Water Code §§ 13000 et seq., the Safe Drinking Water and Toxic Enforcement Act of 1986 (Proposition 65); and Title 22 of the California Code of Regulations, Division 4, Chapter 30; (d) any other chemical, material or substance, exposure to which is prohibited, limited or regulated by any governmental authority or agency or may or could pose a hazard to the health and safety of the occupants of the Project or the owners and/or occupants of property adjacent to or surrounding the Project, or any other person coming upon the Project or adjacent property; or (e) any other chemical, materials or substance which may or could pose a hazard to the environment.

“Indenture” means the indenture, as originally executed or as it may from time to time be supplemented, modified or amended by any supplemental indenture entered into pursuant to the provisions of the Indenture.

“Independent Consultant” means a firm (but not an individual) which (1) is in fact independent, (2) does not have any direct financial interest or any material indirect financial interest in the Borrower or any affiliate thereof and (3) is not connected with the Borrower or any affiliate thereof as an officer, employee, promoter, underwriter, trustee, partner, director or Person performing similar functions, and designated by the Borrower, qualified to pass upon questions relating to the financial affairs of facilities of the type or types operated by the Borrower and having a favorable reputation for skill and experience in the financial affairs of such facilities.

“Indirect Costs” means all title insurance premiums, survey charges, engineering fees, architectural fees, real estate taxes, appraisal costs, premiums for insurance, marketing, advertising and leasing costs, brokerage commissions, legal fees, accounting fees, overhead and administrative costs, and all other expenses as shown on the Development Budget that are expenditures relating to the Project and are not Direct Costs.

“Intercept” means the apportionment from the State Controller, pursuant to Section 17199.4(a)(4) of the Education Code (or any successor provision) and the Intercept Notice, of amounts specified in the Intercept Notice and payable directly to the Trustee.

“Intercept Notice” means any notice from any School to the State Controller, pursuant to Section 17199.4(a)(1) and (4) of the Education Code (or any successor provision), specifying a transfer schedule for the payment directly to the Trustee of one or more of the following: (x) principal of the Bonds, (y) interest on the Bonds and (z) other costs necessary or incidental to financing pursuant to the Act relating to the Bonds, including Additional Payments, in substantially the form set forth in the applicable Lease, as the same may be amended, supplemented or restated from time to time.

“Insurance and Condemnation Proceeds Fund” means the fund by that name established pursuant to the Indenture.

“Interest Account” means the account by that name in the Revenue Fund established pursuant to the Indenture.

“Interest Payment Date” means each January 1 and July 1, commencing January 1, 2015.

“Irrevocable Deposit” means the irrevocable deposit in trust of cash in an amount (or Government Obligations the principal of and interest on which will be in an amount), and under terms sufficient to pay all or a portion of the principal of and/or premium, if any, and interest on, as the same shall become due, of any indebtedness of the Borrower which would otherwise be considered Outstanding. The trustee of such deposit may be any trustee or escrow agent authorized to act in such capacity.

“Lease” means that certain Lease Agreement, dated as of June 1, 2014, by and between the Borrower as lessor and Lessee as lessee, for use and occupation of the premises described therein by the School, as the same may be amended and supplemented in accordance with its terms and with the terms of the Loan Agreement.

“Lessee” means MERF, and its successors and assigns to the extent set forth in the Lease.

“Lien” means any mortgage or pledge of, security interest in or lien or encumbrance on the Facility or the Gross Revenues.

“Loan” means the loan of Bond proceeds from the Authority to the Borrower pursuant to the Loan Agreement.

“Loan Agreement” means that certain loan agreement, dated as of June 1, 2014, between the Authority and the Borrower, as originally executed or as it may from time to time be supplemented, modified or amended subject to and in accordance with the terms thereof and of the Indenture.

“Loan Repayments” has the meaning given such term in the Loan Agreement.

“MERF” means Magnolia Educational & Research Foundation, the operator of a charter school subject to the Charter School Law and organized as a California nonprofit public benefit corporation, doing business as Magnolia Public Schools, its successors and assigns.

“Mandatory Sinking Account Payment” means the amount so designated which is established pursuant to the Indenture with respect to the Bonds.

“Moody’s” means Moody’s Investors Service, a corporation organized and existing under the laws of the State of Delaware, its successors and assigns, or, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, any other nationally recognized securities rating agency designated by the Borrower.

“Opinion of Bond Counsel” means an Opinion of Counsel by a nationally recognized bond counsel firm experienced in matters relating to the exclusion from gross income for federal income tax purposes of interest payable on obligations of state and political subdivisions.

“Opinion of Counsel” means a written opinion of counsel (which may be counsel for the Authority) selected by the Authority. If and to the extent required by the provisions of the Indenture, each Opinion of Counsel shall include the statements provided for in the Indenture.

“Optional Redemption Account” means the account by that name in the Redemption Fund established pursuant to the Indenture.

“Outstanding,” when used as of any particular time with reference to Bonds, means (subject to the provisions of the Indenture) all Bonds theretofore, or thereupon being, authenticated and delivered by the Trustee under the Indenture except (a) Bonds theretofore canceled by the Trustee or surrendered to the Trustee for cancellation; (b) Bonds with respect to which all liability of the Authority shall have been discharged in accordance with the Indenture; and (c) Bonds for the transfer or exchange of which, or in lieu of or in substitution for which, other Bonds shall have been authenticated and delivered by the Trustee pursuant to the Indenture.

“Payments” means (i) all moneys (except any money received to be used for the payment of Administrative Fees and Expenses) received by the Trustee with respect to the Intercept, (ii) all moneys, if any, received by the Trustee directly from, or on behalf of, the Borrower, pursuant to the Loan Agreement (excluding Additional Payments), and (iii) all income derived from the investment of any money in any fund or account established pursuant to the Indenture.

“Permitted Liens” means:

(a) Liens arising by reason of good faith deposits by the Borrower in connection with leases of real estate, bids or contracts (other than contracts for the payment of money), deposits to secure public or statutory obligations, or to secure, or in lieu of, surety, stay or appeal bonds, and deposits as security for the payment of taxes or assessments or other similar charges;

(b) Any Lien arising by reason of deposits with, or the giving of any form of security to, any governmental agency or any body created or approved by law or governmental regulation for any purpose at any time as required by law or governmental regulation as a condition to the transaction of any business or the exercise of any privilege or license, or to enable the Borrower to maintain self-insurance or to participate in any funds established to cover any insurance risks or in connection with workers' compensation, unemployment insurance, pension or profit sharing plans or other social security benefits, or to share in the privileges or benefits required for companies participating in such arrangements;

(c) Any judgment lien against the Borrower so long as such judgment is being contested in good faith and execution thereon is stayed;

(d) Liens shown on the title policy for any Facility, including (i) rights reserved to or vested in any municipality or public authority by the terms of any right, power, franchise, grant, license, permit or provision of law, affecting any Property; (ii) any liens on any Property for taxes, assessments, levies, fees, water and sewer rents, and other governmental and similar charges and any liens of mechanics, materialmen, laborers, suppliers or vendors for work or services performed or materials furnished in connection with such Property, which are not due and payable or which are not delinquent or which, or the amount or validity of which, are being contested and execution thereon is stayed or, with respect to liens of mechanics, materialmen, laborers, suppliers or vendors, have been due for less than ninety (90) days; (iii) easements, rights-of-way, servitudes, restrictions, oil, gas or other mineral reservation and other minor defects, encumbrances, and irregularities in the title to any Property which do not materially impair the use of such Property or materially and adversely affect the value thereof; (iv) the rights of the Authority and the Trustee under the Indenture, the Loan Agreement and the Deed of Trust; and (v) landlord's liens;

(e) Any Lien arising by reason of any escrow established to pay debt service with respect to the Bonds; and

(f) Any Lien securing the obligations of the Borrower under the Loan Agreement (including in respect of Additional Bonds), including the Lien of the Deed of Trust.

"Person" means an individual, corporation, firm, association, partnership, trust or other legal entity or group of entities, including a governmental entity or any agency or political subdivision thereof.

"Plans and Specifications" means the plans and specifications for any portion of the Facility prepared by the Borrower, as the same may be amended, modified, or supplemented in accordance with the terms of the Indenture.

"Principal Account" means the account by that name in the Revenue Fund established pursuant to the Indenture.

"Principal Corporate Trust Office" means for the Trustee originally appointed under the Indenture, the corporate trust office of The Bank of New York Mellon Trust Company, N.A., which a the date of execution of the Indenture is that specified in the Indenture, provided however, that for purposes of presentation of Bonds for payment or for registration of transfer and exchange such term shall mean the office or agency of the Trustee at which, at any particular time, its corporate trust agency business shall be conducted.

"Principal Payment Date" means the principal and Mandatory Sinking Account Payment dates for the Bonds, which dates occur on July 1 of each year commencing July 1, 2016.



“Project” has the meaning given to such term in the Loan Agreement.

“Project Fund” means the fund by that name established pursuant to the Indenture.

“Property” means any and all rights, titles and interests in and to any and all property of the Borrower whether real (including the Facility) or personal, tangible or intangible and wherever situated whether currently owned or acquired in the future.

“Property, Plant and Equipment” means all Property which is property, plant and equipment under generally accepted accounting principles.

“Punchlist Items” means any items necessary at the time of the issuance of a temporary use and occupancy permit to complete the Project in accordance with the Plans and Specifications, or required for the issuance of a final certificate of occupancy or its equivalent.

“Rating Agency” means at any time any nationally recognized rating agency including Fitch, Moody’s or S&P, then rating the Bonds at the request of the Authority or the Borrower.

“Rating Category” means (i) with respect to any long-term rating category, all ratings designated by a particular letter or combination of letters, without regard to any numerical modifier, plus or minus sign or other modifier and (ii) with respect to any short-term or commercial paper rating category, all ratings designated by a particular letter or combination of letters and taking into account any numerical modifier, but not any plus or minus sign or other modifier.

“Rebate Analyst” means the Person engaged by the Borrower to calculate any rebate liability under the Code.

“Rebate Fund” means the fund by that name established pursuant to the Indenture.

“Record Date” means, with respect to the Interest Payment Date for the Bonds, the fifteenth day of the calendar month immediately preceding such Interest Payment Date, whether or not such day is a Business Day.

“Refunding Bonds” means Bonds authorized by and at any time Outstanding pursuant hereto as additional parity Bonds and executed, issued and delivered in accordance with the Indenture, proceeds of which are used to refund all or any portion of Outstanding Bonds.

“Rental Payments” means the amounts payable pursuant to the Lease by the Lessee to the Borrower for the use and occupancy of the Facility, excluding Expenses (as defined in the Lease).

“Repair and Replacement Fund” means the fund by such name established pursuant to the Indenture.

“Repair and Replacement Fund Requirement” means \$100,000.00.

“Reserve Account” means the account by that name in the Revenue Fund established pursuant to the Indenture.

“Reserve Account Requirement” means as of any date of calculation, an amount which shall be equal to the least of (a) ten percent (10%) of the proceeds of the Bonds; (b) maximum annual debt service with respect to the Bonds Outstanding, (c) one hundred twenty-five percent (125%) of average annual

debt service with respect to the Bonds, or (d) for the last Bond Year only, the total debt service with respect to the Bonds Outstanding. Annual debt service and average annual debt service, for purposes of this definition, shall be calculated on the basis of twelve-month periods ending on July 1 of any year in which Bonds are Outstanding.

“Responsible Officer” of the Trustee means the president, any vice president, any assistant vice president, the secretary, any assistant secretary, the treasurer, any assistant treasurer, any senior associate, any associate or any other officer of the Trustee within the Principal Corporate Trust Office (or any successor corporate trust office) customarily performing functions similar to those performed by the persons who at the time shall be such officers, respectively, or to whom any corporate trust matter is referred at the Principal Corporate Trust Office because of such person’s knowledge of and familiarity with the particular subject and having direct responsibility for the administration of the Indenture.

“Retained Rights” means Authority right to payment of the Administrative Fees and Expenses, any Additional Payments, any right to be indemnified, held harmless or defended, any right to receive information, reports, certifications or other documents and any right to notice, consent or inspection hereunder or under the Loan Agreement.

“Revenue Fund” means the fund by that name established pursuant to the Indenture.

“S&P” means Standard & Poor’s Ratings Services, a Standard & Poor’s Financial Services LLC business, a corporation organized and existing under the laws of the State of New York, its successors and assigns, or, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, any other nationally recognized securities rating agency designated by the Authority.

“S&P Surveillance Fee” means the annual fee payable to S&P in accordance with the Indenture.

“School” means Magnolia Science Academy-1, also known as Magnolia Science Academy, established pursuant to the Charter School Law, its successors and assigns.

“Securities Depositories” means The Depository Trust Company, 55 Water Street, 50th Floor, New York, N.Y. 10041-0099 Attention. Call Notification Department, Fax (212) 855-7232 or to such other addresses and/or such other securities depositories as the Authority may designate to the Trustee in writing.

“Series” means, when used with reference to the Bonds, all of the Bonds authenticated and delivered on original issuance and identified pursuant to the Indenture as a separate Series of Bonds, and any Bonds thereafter authenticated and delivered in lieu of or in substitution for such Bonds pursuant to the Indenture, regardless of variations in maturity, interest rate, sinking fund installments or other provisions.

“Sinking Fund Installment” means, with respect to any Term Bonds, each amount so designated for such Term Bonds requiring payments by the Borrower from the Payments to be applied to the retirement of such Bonds on and prior to the stated maturity date thereof.

“Sole Member” means Magnolia Properties Management, Inc., a California nonprofit public benefit corporation, its successors and assigns.

“Special Record Date” means the date established by the Trustee pursuant to the Indenture as a record date for the payment of defaulted interest on Bonds.

“Special Redemption Account” means the account by that name in the Redemption Fund established pursuant to the Indenture.

“State” means the State of California.

“State Controller” means the Controller of the State.

“State School Fund” means the fund established and maintained in the general fund of the State pursuant to Articles 1 and 2 of Chapter 1 of Part 9 of Division 1 of Title 1 of the Education Code.

“Supplemental Indenture” or “Indenture supplemental thereto” means any indenture hereafter duly authorized and entered into between the Authority and the Trustee in accordance with the provisions of the Indenture.

“Tax Certificate and Agreement” means the Tax Certificate of the Authority and the Borrower dated the date of issuance of the Bonds, as the same may be amended or supplemented in accordance with its terms.

“Tax-Exempt Bonds” means the 2014A Bonds.

“Term Bonds” means Bonds which are payable on or before their specified maturity dates from Mandatory Sinking Account Payments established for that purpose and calculated to retire such Bonds on or before their specified maturity dates.

“Trustee” means The Bank of New York Mellon Trust Company, N.A., or the successor as Trustee as provided in the Indenture.

“Underwriter” means RBC Capital Markets, LLC, its successors and assigns.

“2014 Bonds” means the 2014A Bonds and the 2014B Bonds.

“2014A Bonds” means the California School Finance Authority School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project), Series 2014A.

“2014B Bonds” means the California School Finance Authority School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project), Series 2014B (Taxable).

## **THE INDENTURE**

*The Indenture provides for, among other things, the issuance, execution and delivery of Bonds and sets forth the terms thereof, the nature and extent of the security, various rights of Bondholders, rights, duties and immunities of the Trustee and the rights and obligations of the Authority.*

*Certain provisions of the Indenture setting forth the terms of the Bonds, the redemption provisions thereof and the use of the proceeds of the Bonds are set forth elsewhere in this Official Statement. See “THE BONDS,” “ESTIMATED SOURCES AND USES OF FUNDS” and “SECURITY AND SOURCES OF PAYMENT FOR THE BONDS.” Certain provisions of the Indenture are summarized below. **This summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of the Indenture.***

## **The Bonds**

*Bond Register.* The Trustee will keep or cause to be kept, at its Principal Corporate Trust Office, sufficient books for the registration of transfer of the Bonds, which will at all reasonable times during normal business hours upon reasonable notice be open to inspection by the Authority; and, upon presentation for such purpose, the Trustee will, under such reasonable regulations as it may prescribe, register the transfer or cause to be registered the transfer, on said books, of Bonds as hereinbefore provided.

*Temporary Bonds.* The Bonds may be initially issued in temporary form exchangeable for definitive Bonds when ready for delivery. The temporary Bonds may be printed, lithographed or typewritten, will be of such denomination as may be determined by the Authority, will be in registered form and may contain such reference to any of the provisions of the Indenture as may be appropriate. Every temporary Bond will be executed by the Authority and authenticated by the Trustee upon the same conditions and in substantially the same manner as the definitive Bonds. If the Authority issues temporary Bonds, it will execute and furnish definitive Bonds without delay, and thereupon the temporary Bonds may be surrendered, for cancellation, in exchange therefor at the Principal Corporate Trust Office of the Trustee, and the Trustee will authenticate and deliver in exchange for such temporary Bonds an equal aggregate principal amount of definitive Bonds of authorized denominations, of the same maturity or maturities. Until so exchanged, the temporary Bonds will be entitled to the same benefits under the Indenture as definitive Bonds authenticated and delivered under the Indenture.

*Bonds Mutilated, Lost, Destroyed or Stolen.* If any Bond will become mutilated, the Authority, at the expense of the Holder of said Bond, will execute, and the Trustee will thereupon authenticate and deliver, a new Bond of like tenor in exchange and substitution for the Bond so mutilated, but only upon surrender to the Trustee of the Bond so mutilated. Every mutilated Bond so surrendered to the Trustee will be canceled by it and delivered to, or upon the order of, the Authority. If any Bond issued under the Indenture will be lost, destroyed or stolen, evidence of such loss, destruction or theft may be submitted to the Trustee and, if such evidence be satisfactory to it and indemnity satisfactory to it will be given, the Authority, at the expense of the Holder, will execute, and the Trustee will thereupon authenticate and deliver, a new Bond of like tenor in lieu of and in substitution for the Bond so lost, destroyed or stolen. If any Bond mutilated, lost, destroyed or stolen will have matured, instead of issuing a substitute Bond the Trustee may pay the same without surrender upon receipt of indemnity satisfactory to the Trustee. The Authority may require payment from the Holder of a sum not exceeding the actual cost of preparing each new Bond issued under this paragraph and of the expenses which may be incurred by the Authority and the Trustee. Any Bond issued under the provisions summarized in this paragraph in lieu of any Bond alleged to be lost, destroyed or stolen will constitute an original additional contractual obligation on the part of the Authority whether or not the Bond so alleged to be lost, destroyed or stolen be at any time enforceable by anyone, and will be entitled to the benefits of the Indenture with all other Bonds secured by the Indenture.

## **Pledge and Assignment; Establishment and Application of Funds and Accounts**

### *Pledge and Assignment.*

(a) Subject only to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture, there are pledged to secure the payment of the principal of and interest on the Bonds in accordance with their terms and the provisions of the Indenture, all of the Payments (except Payments described in clause (i) of the definition thereof) and any other amounts (excluding proceeds of the sale of Bonds) held in any fund or account (other than the Rebate Fund and the Repair and Replacement Fund) established pursuant to the Indenture. Said pledge

will constitute a lien on and security interest in such assets and will attach and be valid and binding from and after delivery of the Bonds, without any physical delivery thereof or further act.

(b) The Authority assigns to the Trustee, for the benefit of the Holders from time to time of the Bonds, all of the Payments (except Payments described in clause (i) of the definition thereof) and other amounts pledged in paragraph (a) above and all of the right, title and interest of the Authority in, to and under the Loan Agreement (except for the Retained Rights). The Trustee will be entitled to and will receive all of such assigned Payments, and any such Payments collected or received by the Authority will be deemed to be held, and to have been collected or received, by the Authority as the agent of the Trustee and will forthwith be paid by the Authority to the Trustee. The Trustee also will be entitled to and will (subject to the provisions of the Indenture, including its rights and protections under the Indenture) take all steps, actions and proceedings following any event of default under the Loan Agreement reasonably necessary in its judgment to enforce, either jointly with the Authority or separately, all of the rights of the Authority assigned to the Trustee and all of the obligations of the Borrower under the Loan Agreement.

(c) The Trustee shall take all actions necessary for the Trustee to collect directly from the State Controller the amounts set forth in the Intercept Notice on the dates set forth in the Intercept Notice.

(d) All Payments will be promptly deposited by the Trustee upon receipt thereof in a special fund designated as the "Revenue Fund" which the Trustee is directed by the Indenture to establish, maintain and hold in trust. All Payments will be held in trust for the benefit of the Holders from time to time of the Bonds but will nevertheless be disbursed, allocated and applied solely for the uses and purposes set forth in the Indenture.

(e) The Bonds are not and will not be deemed to constitute a debt or liability of the State, or any political subdivision thereof, and are not and shall not be deemed to be a pledge of the faith and credit of the State, or any political subdivision thereof, other than the Authority, which shall be obligated to pay the Bonds solely from the Payments and funds in the Indenture provided therefor. The issuance of the Bonds will not directly or indirectly or contingently obligate the State or any political subdivision thereof to levy or to pledge any form of taxation whatsoever for the Bonds or to make any appropriation for their payment. Nothing in the Indenture, the Act or otherwise is an undertaking by the Authority or the State or any political subdivision thereof to fund the transfers described in the Intercept Notice or to funds available to the Lessee in any amount or at any time.

*Establishment and Application of Redemption Fund.* The Trustee will establish and maintain within the Redemption Fund a separate Optional Redemption Account and a separate Special Redemption Account. The Trustee will accept all moneys deposited for redemption and will deposit such moneys into the Optional Redemption Account or the Special Redemption Account, as applicable. All amounts deposited in the Optional Redemption Account and in the Special Redemption Account will be accepted and used and withdrawn by the Trustee solely for the purpose of redeeming Bonds, in the manner and upon the terms and conditions specified in the redemption provisions of the Indenture, at the next succeeding date of redemption for which notice has not been given and at the redemption prices then applicable to redemptions from the Optional Redemption Account and the Special Redemption Account, respectively; provided that, at any time prior to giving such notice of redemption, the Trustee will, upon written direction of the Borrower, apply such amounts to the purchase of Bonds at public or private sale, as and when and at such prices (including brokerage and other charges, but excluding accrued interest, which is payable from the Interest Account) as the Borrower may direct, except that the purchase price (exclusive of accrued interest) may not exceed the redemption price then applicable to such Bonds (or, if such Bonds are not then subject to redemption, the par value of such Bonds); and provided further that in the case of the Optional Redemption Account in lieu of redemption at such next succeeding date of redemption, or in combination therewith, amounts in such account may be transferred to the Revenue

Fund and credited against Loan Repayments in order of their due date as set forth in a Request of the Borrower.

*Rebate Fund.*

(a) The Trustee will establish and maintain, when required, a fund separate from any other fund established and maintained under the Indenture designated as the Rebate Fund. Within the Rebate Fund, the Trustee will maintain such accounts as will be necessary to comply with instructions of the Borrower given pursuant to the terms and conditions of the Tax Certificate. Subject to the transfer provisions provided in paragraph (e) below, all money at any time deposited in the Rebate Fund will be held by the Trustee in trust, to the extent required to satisfy the Rebate Requirement (as defined in the Tax Certificate), for payment to the federal government of the United States of America. Neither the Authority, the Borrower nor the Holder of any Bonds will have any rights in or claim to such money. All amounts deposited into or on deposit in the Rebate Fund will be governed by the provisions summarized under this caption “*–Rebate Fund,*” by the provisions summarized under the caption “*Covenants–Other Covenants; Amendment of the Loan Agreement*” and by the Tax Certificate (which is incorporated therein by reference). The Trustee will be deemed conclusively to have complied with such provisions if it follows the directions of the Borrower including supplying all necessary information in the manner provided in the Tax Certificate which the Trustee will be directed by the Borrower to supply, and will have no liability or responsibility to enforce compliance by the Borrower or the Authority with the terms of the Tax Certificate or any other tax covenants contained in the Indenture. The Trustee will not be responsible for calculating rebate amounts or for the adequacy or correctness of any rebate report or rebate calculations. The Trustee will have no independent duty to review such calculations or enforce the compliance by the Borrower with such rebate requirements. The Trustee will have no duty or obligation to determine the applicability of the Code and will only be obligated to act in accordance with written instructions provided by the Borrower.

(b) Upon the Borrower’s written direction, an amount will be deposited to the Rebate Fund by the Trustee from deposits by the Borrower, if and to the extent required, so that the balance in the Rebate Fund will equal the Rebate Requirement. Computations of the Rebate Requirement will be furnished by or on behalf of the Borrower in accordance with the Tax Certificate. Upon written request by the Borrower or the Authority, the Trustee is directed to supply to the Borrower and/or the Authority all necessary information in the manner provided in the Tax Certificate and specified in such written direction, to the extent such information is reasonably available to the Trustee.

(c) The Trustee will have no obligation to rebate any amounts required to be rebated pursuant to the provisions of the Indenture summarized under this caption “*–Rebate Fund,*” other than from moneys held in the funds and accounts created under the Indenture or from other moneys provided to it by the Borrower.

(d) At the written direction of the Borrower, which shall include a statement to the effect that such direction complies with the restrictions set forth in the Tax Certificate, the Trustee will invest all amounts held in the Rebate Fund in Eligible Securities. Moneys will not be transferred from the Rebate Fund except as provided in paragraph (e) below. The Trustee will not be liable for any consequences arising from such investment.

(e) Upon receipt of the Borrower’s written directions, the Trustee will remit part or all of the balances in the Rebate Fund to the United States, as so directed. In addition, if the Borrower so directs, the Trustee will deposit money into or transfer money out of the Rebate Fund from or into such accounts or funds as directed by the Borrower’s written directions; provided, however, only moneys in excess of the Rebate Requirement may, at the written direction of the Borrower or the Authority, be transferred out

of the Rebate Fund to such other accounts or funds or to anyone other than the United States in satisfaction of the arbitrage rebate obligation. Any funds remaining in the Rebate Fund after each five year remission to the United States of America, redemption and payment of all of the Bonds and payment and satisfaction of any Rebate Requirement, or provision made therefor satisfactory to the Trustee, will be withdrawn and remitted to the Borrower.

(f) Notwithstanding any other provision of the Indenture, including in particular the defeasance provisions of the Indenture, the obligation to remit the Rebate Requirement to the United States and to comply with all other requirements of the provisions summarized under this caption “*– Rebate Fund,*” the provisions summarized under the caption “*Covenants–Other Covenants; Amendment of the Loan Agreement*” and the Tax Certificate will survive the defeasance or payment in full of the Bonds.

*Establishment and Application of Project Fund.*

(a) The Trustee will establish, maintain and hold in trust a separate fund designated as the “Project Fund.” The moneys in the Project Fund will be disbursed pursuant to Requisitions of the Borrower, which will be substantially in the form provided in the Indenture. Each such Requisition of the Borrower will be sufficient evidence to the Trustee of the facts stated therein and the Trustee will have no duty to confirm the accuracy of such facts. No moneys in the Project Fund will be used to pay Costs of Issuance. The Trustee will accept moneys from the Borrower for deposit in the Project Fund from time to time.

(b) Upon completion of the Project, the Borrower will deliver a Completion Certificate to the Trustee and make the final requisition of funds from the Project Fund. Any amounts thereafter remaining in such Project Fund will be transferred by the Trustee, at the direction of the Borrower (i) to the Redemption Fund for the redemption of Bonds pursuant to the Indenture, or (ii) to the Interest Account for payment of interest on the Bonds, or (iii) to the Borrower upon delivery to the Trustee of (A) a Completion Certificate, (B) a written request of the Borrower and (C) delivery of an Opinion of Bond Counsel to the effect that such transfer would not adversely affect the exclusion from gross income for federal income tax purposes of interest on the Bonds. Upon such transfer, the Project Fund will be closed.

*Establishment and Application of Costs of Issuance Fund; Insurance and Condemnation Proceeds Fund.*

(a) The Trustee will establish, maintain and hold in trust a separate fund designated as the “Costs of Issuance Fund.” Moneys deposited in said fund will be used and withdrawn by the Trustee to pay the Costs of Issuance of the Bonds upon Requisition of the Borrower stating the person to whom payment is to be made, the amount to be paid, the purpose for which the obligation was incurred and that such payment is a proper charge against said fund, and including a copy of the invoice or statement evidencing the costs incurred. On the one hundred eightieth (180th) day following the initial issuance of the Bonds, or upon the earlier Request of the Borrower, amounts, if any, remaining in the Costs of Issuance Fund will be transferred to the Project Fund, and the Costs of Issuance Fund will be closed.

(b) As and when needed, the Trustee will establish, maintain and hold in trust a separate fund designated as the “Insurance and Condemnation Proceeds Fund,” and administer said fund as set forth in the Loan Agreement.

(c) Before any payment from the Insurance and Condemnation Proceeds Fund will be made, the Borrower will file or cause to be filed with the Trustee a Requisition of the Borrower stating: (1) the

item number of such payment; (2) the name of the Person to whom each such payment is due, which may be the Borrower in the case of reimbursement for costs of such repair or replacement theretofore paid by the Borrower; (3) the respective amounts to be paid; (4) the purpose by general classification for which each obligation to be paid was incurred; (5) that obligations in the stated amounts have been incurred by the Borrower and are presently due and payable and that each item thereof is a proper charge against the Insurance and Condemnation Proceeds Fund and has not been previously paid from the Insurance and Condemnation Proceeds Fund; and (6) that there has not been filed with or served upon the Borrower any notice of claim of lien, or attachment upon, or claim affecting the right to receive payment of, any of the amounts payable to any of the persons named in such Requisition, for which adequate security for the payment of such obligation has been posted, or which has not been released or will not be released simultaneously with the payment of such obligation, other than materialmen's or mechanics' liens accruing by mere operation of law.

(d) Upon receipt of a Requisition, the Trustee will pay the amount set forth in such Requisition as directed by the terms thereof out of the Insurance and Condemnation Proceeds Fund. The Trustee may conclusively rely upon such Requisition and will have no responsibility or duty to investigate any of the matters set forth therein. The Trustee will not make any such payment if it has received any written notice of claim of lien, attachment upon, or claim affecting the right to receive payment of, any of the moneys to be so paid, that has not been released or will not be released simultaneously with such payment, unless adequate security for the payment of such obligation has been posted.

(e) When the repair or replacement of damaged, destroyed or taken property will have been completed, the Borrower will deliver to the Trustee a Certificate of the Borrower stating the fact and date of such completion and stating that all of the costs thereof have been determined and paid (or that all of such costs have been paid less specified claims that are subject to dispute and for which a retention in the Insurance and Condemnation Proceeds Fund is to be maintained in the full amount of such claims until such dispute is resolved). Subject to the Loan Agreement, the Borrower will direct the Trustee by said Certificate of the Borrower to transfer any remaining balance in the Insurance and Condemnation Proceeds Fund, less the amount of any such retention, to the Special Redemption Account of the Redemption Fund or, at the election of the Borrower, to the Revenue Fund. Upon the disbursement of all moneys in the Insurance and Condemnation Proceeds Fund, such fund will thereafter be closed until such time as such fund is again required to be established pursuant to paragraph (b) above.

*Establishment and Application of the Repair and Replacement Fund.*

(a) The Trustee will establish, maintain and hold in trust a separate fund designated as the "Repair and Replacement Fund," which will be used solely for the purposes set forth in the provisions summarized under this caption "*Establishment and Application of the Repair and Replacement Fund.*"

(b) The Authority, by the Indenture, authorizes and directs the Trustee to withdraw funds from the Repair and Replacement Fund to pay for capital items not budgeted as ordinary maintenance and repair costs related to the Facility.

(c) Moneys in the Repair and Replacement Fund to be used for the purpose described in the preceding paragraph (b) will be disbursed upon receipt of a Requisition of the Borrower for payment substantially in the form provided in the Indenture, executed by the Authorized Borrower Representative, and the Trustee will issue its checks for each such disbursement upon receipt of such a requisition. The Trustee may conclusively rely upon such Requisition and shall have no responsibility or duty to investigate any of the matters set forth therein.



(d) When (i) the amount of principal of, and premium, if any, and interest on the Outstanding Bonds is equal to or less than the sum of the balance of the Revenue Fund, the balance of the Redemption Fund and the balance of the Repair and Replacement Fund, and (ii) all other amounts owed under the Loan Agreement and the Indenture will have been paid, moneys held in the Repair and Replacement Fund may be deposited into the Revenue Fund and credited against payments of Loan Repayments required under the Loan Agreement.

*Investment of Moneys in Funds and Accounts.*

Except as otherwise provided in provisions of the Indenture summarized under “Defeasance—Deposit of Money or Securities with Trustee” below, all moneys in any of the funds and accounts or subaccounts thereof established pursuant to the Indenture, except the Grant-Funded Reserve Subaccount of the Reserve Account, will be invested by the Trustee solely in such Eligible Securities as are specified in a Request of the Borrower, provided, however, that, if the Borrower does not file such a Request with the Trustee, the Trustee will invest to the extent practicable in investments described in clause (7) of the definition of the term “Eligible Securities” above; provided, however, that any such investment will be made by the Trustee only if, prior to the date on which such investment is to be made, the Trustee will have received a Request of the Borrower specifying a specific money market fund and, if no such Request of the Borrower is so received, the Trustee will hold such moneys uninvested.

All moneys in the Grant-Funded Reserve Subaccount of the Reserve Account will be invested by the Trustee solely in such Grant-Funded Reserve Eligible Securities as are specified in a Request of the Borrower, provided, however, that, if the Borrower does not file such a Request with the Trustee, the Trustee will invest to the extent practicable in “Grant-Funded Reserve Eligible Securities,” as such term is defined in the Indenture; provided, however, that any such investment will be made by the Trustee only if, prior to the date on which such investment is to be made, the Trustee will have received a Request of the Borrower specifying a specific money market fund and, if no such Request of the Borrower is so received, the Trustee will hold such moneys uninvested.

All interest, profits and other income received from the investment of moneys will be deposited in the Revenue Fund; provided, however, all interest, profits and other income received from the investment of moneys in the Bond Reserve Subaccount and the Grant-Funded Reserve Subaccount of the Reserve Account shall remain in such Subaccount.

Subject to the provisions of the Indenture summarized under “Defeasance—Deposit of Money or Securities with Trustee” below, investments in any and all funds and accounts established pursuant to the Indenture may be commingled for purposes of making, holding and disposing of investments, notwithstanding provisions in the Indenture for transfer to or holding in a particular fund amounts received or held by the Trustee under the Indenture, provided that the Trustee will at all times account for such investments strictly in accordance with the particular funds to which they are credited and otherwise as provided in the Indenture. The Trustee may act as principal or agent in the making or disposing of any investment. To the extent Eligible Securities are registrable, such investments will be registered in the name of the Trustee. The Trustee may sell or present for redemption, any securities so purchased whenever it will be necessary to provide moneys to meet any required payment, transfer, withdrawal or disbursement from the fund or account to which such securities are credited, and the Trustee will not be liable or responsible for any loss resulting from such investment. The Trustee may rely on the investment directions of the Authority as to both the suitability and legality of the directed investments. In no event will the Trustee be liable for the selection of investments or for investment losses incurred thereon. The Trustee may make any and all such investments through its own investment department or that of its affiliates or subsidiaries, and may charge its ordinary and customary fees for such trades, including investment maintenance fees. Ratings of Eligible Securities or Grant-Funded Reserve Eligible Securities

shall be determined at the time of purchase of such Eligible Securities or Grant-Funding Reserve Eligible Securities and without regard to ratings subcategories.

The Trustee is authorized by the Indenture, in making or disposing of any investment permitted by the provisions of the Indenture summarized under this caption “*Investment of Moneys in Funds and Accounts*,” to deal with itself (in its individual capacity) or with any one or more of its affiliates, whether it or such affiliate is acting as an agent of the Trustee or for any third person or dealing as principal for its own account. No float forward or forward purchase agreement or other arrangement, agreement or financial product may be utilized in connection with the Revenue Fund.

The Borrower and the Authority acknowledge that to the extent regulations of the Comptroller of the Currency or other applicable regulatory entity grant the Borrower or the Authority, as applicable, the right to receive brokerage confirmations of security transactions as they occur, the Borrower and the Authority specifically waive receipt of such confirmations to the extent permitted by law. The Trustee will furnish the Borrower periodic cash transaction statements which include detail for all investment transactions made by the Trustee under the Indenture.

## **Covenants**

*Punctual Payment.* The Authority will punctually pay, but only out of Payments and pledged funds as provided in the Indenture, the principal and interest to become due in respect of every Bond issued under the Indenture at the times and places and in the manner provided in the Indenture and in the Bonds, according to the true intent and meaning thereof.

*Extension of Payment of Bonds.* The Authority will not directly or indirectly extend or assent to the extension of the maturity of any of the Bonds or the time of payment of any of the claims for interest by the purchase or funding of such Bonds or claims for interest or by any other arrangement except with the written consent of the Bondholders and, if the maturity of any of the Bonds or the time of payment of any such claims for interest will be extended without the written consent of the Bondholders, such Bonds or claims for interest will not be entitled, in case of any default under the Indenture, to the benefits of the Indenture, except subject to the prior payment in full of the principal of all of the Bonds then Outstanding and of all claims for interest thereon which will not have been so extended. Nothing in this paragraph will be deemed to limit the right of the Authority to issue Bonds for the purpose of refunding any Outstanding Bonds, and such issuance will not be deemed to constitute an extension of maturity of Bonds.

*Encumbrance Upon Payments.* The Authority will not create, or permit the creation of, any pledge, lien, charge or other encumbrance upon the Payments and other assets pledged or assigned under the Indenture while any of the Bonds are Outstanding, except the pledge and assignment created by the Indenture. Subject to this limitation, the Authority expressly reserves the right to enter into one or more other indentures for any of its corporate purposes, including other programs under the Act, and reserves the right to issue other obligations for such purposes.

*Power to Issue Bonds and Make Pledge and Assignment.* The Authority is duly authorized pursuant to law to issue the Bonds and to enter into the Indenture and to pledge and assign the Payments and other assets purported to be pledged and assigned, respectively, under the Indenture in the manner and to the extent provided in the Indenture. The Bonds and the provisions of the Indenture are and will be the valid and binding limited obligations of the Authority, and the Authority and Trustee will at all times, to the extent permitted by law and subject to the provisions of the Indenture, defend, preserve and protect said pledge and assignment of Payments and other assets and all the rights of the Bondholders under the Indenture against all claims and demands of all persons whomsoever.

*Accounting Records and Financial Statements.* The Trustee will at all times keep, or cause to be kept, proper books of record and account, prepared in accordance with the Trustee's accounting practices for books of record and account relating to similar trust accounts and in accordance with the customary standards of the corporate trust industry for such books of record and account, in which complete and accurate entries will be made of all transactions made by it relating to the proceeds of Bonds, the Payments, the Loan Agreement and all funds and accounts established pursuant to the Indenture. Such books of record and account will be available for inspection by the Authority, the Borrower and any Bondholder, or his agent or representative duly authorized in writing, at reasonable hours, upon reasonable notice and under reasonable circumstances.

*Other Covenants; Amendment of the Loan Agreement and the Lease.*

(a) Subject to the provisions of the Indenture, the Trustee will promptly collect all amounts due pursuant to the Loan Agreement and, subject to its rights and protections under the Indenture, diligently enforce and take all steps, actions and proceedings reasonably necessary for the enforcement of all of the rights of the Authority under the Loan Agreement assigned to it pursuant to the Indenture.

(b) The Authority will not amend, modify or terminate any of the terms of the Loan Agreement, the Deed of Trust or the Lease, or consent to any such amendment, modification or termination, without the prior written consent of the Trustee. The Trustee will give such written consent if but only if (1) it has received a written representation from the Borrower to the effect that such amendment or modification will not materially and adversely affect the interests of the Holders of the Bonds; provided that, if an Event of Default described in the Indenture has occurred and is continuing, the Trustee rather than the Borrower will make a determination that such amendment or modification will not materially and adversely affect the interests of the Holders of the Bonds (provided that, in making such determination, the Trustee may conclusively rely on written representations of financial consultants or advisors or the opinion or advice of counsel), or (2) the Holders of a majority in aggregate principal amount of the Bonds then Outstanding consent in writing to such amendment, modification or termination, provided that no such amendment, modification or termination will reduce the amount of Loan Repayments payable to the Authority, or extend the time for making such payments, without the written consent of all of the Holders of the Bonds then Outstanding.

*Further Assurances.* The Authority will make, execute and deliver any and all such further indentures, instruments and assurances as may be reasonably necessary or proper to carry out the intention or to facilitate the performance of the Indenture and for the better assuring and confirming unto the Holders of the Bonds of the rights and benefits provided in the Indenture.

*Continuing Disclosure.* Pursuant to the Loan Agreement, the Borrower has undertaken all responsibility for compliance with continuing disclosure requirements pursuant to Securities and Exchange Commission Rule 15c2-12(b)(5), and the Authority will have no liability to the Holders of the Bonds or any other person with respect to Securities and Exchange Commission Rule 15c2-12. The Trustee covenants and agrees that, subject to the provisions of the Indenture, it will comply with and carry out all of the provisions of the Continuing Disclosure Agreement and provisions of the Loan Agreement related to continuing disclosure applicable to it. Notwithstanding any other provision of the Indenture, failure of the Borrower or the Trustee to comply with the Continuing Disclosure Agreement will not be considered an Event of Default; however, the Trustee at the written request of the Underwriter (as defined in the Continuing Disclosure Agreement) or the Holders of at least 25% aggregate principal amount of Outstanding Bonds, will (but only to the extent the Trustee has been tendered funds in an amount satisfactory to it or it has been otherwise indemnified from and against any loss, liability, cost or expense, including without limitation, fees and expenses of its counsel and agents and additional fees and charges of the Trustee) or any Bondholder or Beneficial Owner may take such actions as may be necessary and

appropriate, including seeking mandate or specific performance by court order, to cause the Borrower to comply with its obligations under the continuing disclosure provisions of the Loan Agreement or, as to any Bondholder or Beneficial Owner, to cause the Trustee to comply with its obligations under this Section. For purposes of this paragraph, “Beneficial Owner” means any person which (1) has the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries), or (2) is treated as the owner of any Bonds for federal income tax purposes.

#### *Tax Covenants.*

(a) The Authority covenants that it will not take any action, or fail to take any action, if such action or failure to take such action would result in the interest on the Tax-Exempt Bonds not being excluded from gross income for federal income tax purposes under Section 103 of the Code. Without limiting the generality of the foregoing, the Authority covenants that it will comply with the requirements of the Tax Certificate, which is incorporated therein as if fully set forth therein. This covenant will survive the payment in full or the defeasance of the Tax-Exempt Bonds.

(b) In the event that at any time the Authority is of the opinion that for purposes of the provisions summarized under this caption “*–Tax Covenants*” it is necessary or helpful to restrict or limit the yield on the investment of any moneys held by the Trustee under the Indenture, and provided that such action shall not conflict with the requirements of the Tax Certificate, the Authority will so instruct the Trustee in a Request of the Authority (which may be accompanied by a supporting Opinion of Bond Counsel), and the Trustee will take such action as may be directed in accordance with such instructions.

(c) Notwithstanding any provisions summarized under this caption “*–Tax Covenants*” , if the Authority will provide to the Trustee an Opinion of Bond Counsel to the effect that any specified action required under this paragraph is no longer required or that some further or different action is required to maintain the exclusion from federal income tax of interest on the Tax-Exempt Bonds, the Trustee may conclusively rely on such opinion in complying with the requirements of the provisions of the Indenture regarding tax covenants and the Tax Certificate, and the covenants under the Indenture will be deemed to be modified to that extent.

*Intercept Covenants.* The Trustee will, on each Interest Payment Date, each Principal Payment Date, or on which a transfer from the Controller to the Trustee is scheduled pursuant to the Intercept Notice, notify the Authority and the Borrower of any shortfall in amounts received by the Trustee from the Controller compared to the amounts set forth in the Intercept Notice for such date. If, subsequent to any shortfall for which the Trustee has sent notice pursuant to the preceding sentence, the Trustee will receive payment of amounts sufficient to cure such shortfall, the Trustee shall, within ten (10) business days thereof, notify the Authority and the Borrower of the receipt of such payment. The Trustee will not be required to take any action in connection with the foregoing except as specifically set forth in this paragraph.

#### **Events of Default; Remedies on Default**

*Events of Default; Waiver of Default.* If one or more of the following events (“Events of Default”) will happen, that is to say: (a) if default will be made by the Authority in the due and punctual payment of the principal of any Bond as the same will become due and payable (whether at maturity, by declaration or otherwise); (b) if default will be made by the Authority in the due and punctual payment of interest on any Bond when and as such interest will become due and payable; or (c) if default will be made by the Authority in the performance or observance of any other of the covenants, agreements or conditions on its part in the Indenture or in the Bonds contained, and such default will have continued for

a period of thirty (30) days after written notice thereof, specifying such default and requiring the same to be remedied, will have been given to the Authority by the Trustee, or to the Authority, the Borrower and the Trustee by the Holders of not less than a majority in aggregate principal amount of the Bonds at the time Outstanding; then and in each and every such case during the continuance of such Event of Default, the provisions summarized in the following paragraphs under “*Institution of Legal Proceedings by Trustee*” apply.

*Institution of Legal Proceedings by Trustee.*

(a) If one or more of the Events of Default will occur, the Trustee in its discretion may, and upon the written request of the Holders of a majority in principal amount of the Bonds then Outstanding, and upon being indemnified to its satisfaction therefor, the Trustee will proceed to protect or enforce its rights or the rights of the holders of Bonds under the Indenture, the Loan Agreement, the Lease and the Deed of Trust, by a suit in equity or action at law, either for the specific performance of any covenant or agreement contained in the Indenture or therein, or in aid of the execution of any power in the Indenture or therein granted, or by mandamus or other appropriate proceeding for the enforcement of any other legal or equitable remedy as the Trustee will determine in support of any of its rights or duties under the Indenture, provided that any such request from the Bondholders will not be in conflict with any rule of law or with the Indenture, expose the Trustee to personal liability or be unduly prejudicial to Bondholders not joining therein.

(b) Notwithstanding anything to the contrary in the Indenture, the Authority will have no obligation to, and instead the Trustee may, without further direction from the Authority, take any and all steps, actions and proceedings, to enforce any or all rights of the Authority (other than those specifically retained by the Authority pursuant to the provisions of the Indenture summarized under the caption “*Pledge and Assignment—Pledge and Assignment*” above) under the Indenture or the Loan Agreement, including, without limitation, the rights to enforce the remedies upon the occurrence and continuation of an Event of Default and the obligations of the Borrower under the Loan Agreement.

(c) Nothing in the Indenture will be deemed to authorize the Trustee to authorize or consent to or accept or adopt on behalf of any Bondholder any plan of reorganization, arrangement, adjustment, or composition affecting the Bonds or the rights of any Bondholder thereof, or to authorize the Trustee to vote in respect of the claim of any Bondholder in any such proceeding without the approval of the Bondholders so affected.

(d) Anything in the Indenture or Loan Agreement to the contrary notwithstanding, the Trustee will not be required to enter, take possession of, or take any other action whatsoever with respect to the failure to initiate foreclosure proceedings with respect to the Project unless the Trustee is satisfied that the Trustee will not be subject to any liability under any Environmental Regulations of any kind whatsoever or from any circumstances present at the Project relating to the presence, use, management, disposal or contamination by any environmentally hazardous materials or substances of any kind whatsoever.

*Application of Moneys Collected by Trustee.* Any moneys collected by the Trustee pursuant to the provisions summarized in the paragraphs under “*Institution of Legal Proceedings by Trustee*” above and any other amounts then held by the Trustee under the Indenture, will be applied in the following order, at the date or dates fixed by the Trustee and, in the case of distribution of such moneys on account of principal upon presentation of the Bonds, and stamping thereon the payment, if only partially paid, and upon surrender thereof, if fully paid:

First: To the payment of costs and expenses of collection and reasonable compensation to the Trustee for its own services and for the services of counsel, agents and employees by it properly engaged and employed, and all other expenses and liabilities incurred, and for advances, together with interest on such advances at a rate per annum equal to the Bond yield plus two percent, made pursuant to the provisions of the Indenture.

Second: In case the principal of any of the Bonds will have become due by declaration or otherwise and remains unpaid, first to the payment of interest in default, and then to the payment of the principal of all Bonds then due and unpaid, in every instance such payment to be made ratably to the persons entitled thereto without discrimination or preference.

Whenever moneys are to be applied pursuant to the provisions of the Indenture summarized under this caption “*–Application of Moneys Collected by Trustee,*” such moneys will be applied at such times, and from time to time, as the Trustee will determine, having due regard to the amount of such moneys available for application and the likelihood of additional moneys becoming available for such application in the future. Whenever the Trustee will apply such funds, it will fix the date (which will be the Interest Payment Date unless the Trustee will deem another date more suitable) upon which such application is to be made and upon such date interest on the amounts of principal and past-due interest to be paid on such date will cease to accrue.

Whenever all principal of and interest on all Bonds have been paid under the provisions of the Indenture summarized under this caption “*–Application of Moneys Collected by Trustee,*” and all fees, expenses and charges of the Trustee (including without limitation those of its attorneys) have been paid, any balance remaining in the funds and accounts under the Indenture will be paid to the Borrower.

*Effect of Delay or Omission to Pursue Remedy.* No delay or omission of the Trustee or of any Holder of Bonds to exercise any right or power arising from any default will impair any such right or power or will be construed to be a waiver of any such default or acquiescence therein, and every power and remedy given by provisions of the Indenture governing Events of Default and remedies on default to the Trustee or to the Holders of Bonds may be exercised from time to time, and as often as will be deemed expedient. In case the Trustee will have proceeded to enforce any right under the Indenture, and such proceedings will have been discontinued or abandoned because of waiver or for any other reason, or will have been determined adversely to the Trustee, then and in every such case the Authority and the Trustee, and the Holders of the Bonds, severally and respectively, will be restored to their former positions and rights under the Indenture in respect to the trust estate; and all remedies, rights and powers of the Authority, the Trustee and the Holders of the Bonds will continue as though no such proceedings had been taken.

*Remedies Cumulative.* No remedy in the Indenture conferred upon or reserved to the Trustee or to any Holder of the Bonds is intended to be exclusive of any other remedy, but each and every such remedy will be cumulative and will be in addition to every other remedy given under the Indenture or now or hereafter existing at law or in equity.

*Covenant to Pay Bonds in Event of Default.* The Authority covenants that, upon the happening of any Event of Default, the Authority will pay, but only out of Payments, to the Trustee, upon demand, for the benefit of the Holders of the Bonds, the whole amount then due and payable thereon (by declaration or otherwise) for interest and principal as the case may be, and all other sums which may be due under the Indenture or secured by the Indenture, including reasonable compensation to the Trustee and its agents and counsel and any expenses or liabilities incurred by the Trustee under the Indenture and, its agents and counsel. In case the Authority will fail to pay the same forthwith upon such demand, the Trustee, in its own name and as trustee of an express trust, will be entitled to institute proceedings at law or in equity in

any court of competent jurisdiction to recover judgment for the whole amount due and unpaid, together with costs and reasonable attorneys' fees and expenses, subject, however, to the condition that such judgment, if any, will be limited to, and payable solely out of, Payments as provided in the Indenture and not otherwise. The Trustee will be entitled to recover such judgment as aforesaid, either before or after or during the pendency of any proceedings for the enforcement of the Indenture, and the right of the Trustee to recover such judgment will not be affected by the exercise of any other right, power or remedy for the enforcement of the provisions of the Indenture.

*Trustee Appointed Agent for Bondholders.* The Trustee is appointed by the Indenture the agent and attorney-in-fact of the Holders of all Bonds Outstanding under the Indenture for the purpose of filing any claims relating to the Bonds.

*Power of Trustee to Control Proceedings.* Subject to the immediately following paragraph, in the event that the Trustee, upon the happening of an Event of Default, will have taken some action, by judicial proceedings or otherwise, pursuant to its duties under the Indenture, whether upon its own discretion or upon the request of the Holders of a majority in aggregate principal amount of the Bonds then Outstanding, it will have full power, in the exercise of its discretion for the best interests of the Holders of the Bonds, with respect to the continuance, discontinuance, withdrawal, compromise, settlement or other disposal of such action; provided, however, that the Trustee will not, unless there no longer continues an Event of Default under the Indenture, discontinue, withdraw, compromise or settle, or otherwise dispose of any litigation pending at law or in equity, if at the time there has been filed with it a written request signed by the Holders of at least a majority in aggregate principal amount of the Bonds Outstanding under the Indenture opposing such discontinuance, withdrawal, compromise, settlement or other disposal of such litigation.

*Limitation on Bondholders' Right to Sue.* Notwithstanding any other provision of the Indenture, no Holder of any Bond issued under the Indenture will have the right to institute any suit, action or proceeding at law or in equity, for any remedy under or upon the Indenture, unless (a) such Holder will have previously given to the Trustee written notice of the occurrence of an Event of Default under the Indenture; (b) the Holders of at least a majority in aggregate principal amount of all the Bonds then Outstanding will have made written request upon the Trustee to exercise the powers hereinbefore granted or to institute such action, suit or proceeding in its own name; (c) said Holders will have tendered to the Trustee reasonable indemnity against the costs, expenses and liabilities to be incurred in compliance with such request; and (d) the Trustee will have refused or omitted to comply with such request for a period of sixty (60) days after such written request will have been received by, and said tender of indemnity will have been made to, the Trustee. Such notification, request, tender of indemnity and refusal or omission are declared, in every case, to be conditions precedent to the exercise by any Holder of Bonds of any remedy under the Indenture; it being understood and intended that no one or more Holders of Bonds will have any right in any manner whatever by his or their action to enforce any right under the Indenture, except in the manner provided in the Indenture, and that all proceedings at law or in equity to enforce any provision of the Indenture will be instituted, had and maintained in the manner provided in the Indenture and for the equal benefit of all Holders of the Outstanding Bonds. The right of any Holder of any Bond to receive payment of the principal of and interest on such Bond out of Payments and the funds pledged in the Indenture, as provided in the Indenture, on and after the respective due dates expressed in such Bond, or to institute suit for the enforcement of any such payment on or after such respective dates, will not be impaired or affected without the consent of such Holder, notwithstanding the foregoing provisions of this paragraph or the immediately preceding paragraph or any other provision of the Indenture.

*Authority Retained Rights.* No provision of the Indenture relating to default will limit in any respect the right of the Authority to enforce or waive any of its Retained Rights under the Loan Agreement.

## **The Trustee**

### *Duties, Immunities and Liabilities of Trustee.*

(a) The Trustee will, prior to an Event of Default, and after the curing of all Events of Default which may have occurred, perform such duties and only such duties as are specifically set forth in the Indenture. The Trustee will, during the existence of any Event of Default which has not been cured, exercise such of the rights and powers vested in it by the Indenture, and use the same degree of care and skill in their exercise, as a prudent person would exercise or use under the circumstances in the conduct of his or her own affairs.

(b) The Authority may remove the Trustee at any time unless an Event of Default will have occurred and then be continuing, and will remove the Trustee if at any time requested to do so by the Borrower (unless an Event of Default will have occurred and then be continuing) or at any time by an instrument or concurrent instruments in writing signed by the Holders of not less than a majority in aggregate principal amount of the Bonds then Outstanding (or their attorneys duly authorized in writing) or if at any time the Trustee will cease to be eligible in accordance with paragraph (e) below, or will become incapable of acting, or will be adjudged a bankrupt or insolvent, or a receiver of the Trustee or its property will be appointed, or any public officer will take control or charge of the Trustee or of its property or affairs for the purpose of rehabilitation, conservation or liquidation, in each case by giving written notice of such removal to the Trustee, and thereupon will appoint, with the written consent of the Borrower (unless an Event of Default has occurred and is continuing, at which time consent of the Borrower will not be required) and Holders of not less than a majority in aggregate principal amount of the Bonds then Outstanding (or their attorneys duly authorized in writing), a successor Trustee by an instrument in writing.

(c) The Trustee may at any time resign by giving written notice of such resignation to the Authority, and by giving the Bondholders notice of such resignation by mail at the addresses shown on the Bond registration books maintained by the Trustee. Upon receiving such notice of resignation, the Authority will appoint, with the written consent of the Borrower (unless an Event of Default has occurred and is continuing, at which time consent of the Borrower will not be required) and Holders of not less than a majority in aggregate principal amount of the Bonds then Outstanding (or their attorneys duly authorized in writing), a successor Trustee by an instrument in writing.

(d) Any removal or resignation of the Trustee and appointment of a successor Trustee will become effective upon acceptance of appointment by the successor Trustee. If no successor Trustee will have been appointed and have accepted appointment within forty-five (45) days of giving notice of removal or notice of resignation as aforesaid, the retiring or resigning Trustee or any Bondholder (on behalf of himself and all other Bondholders) may petition any court of competent jurisdiction for the appointment of a successor Trustee, and such court may thereupon, after such notice (if any) as it may deem proper, appoint such successor Trustee. Any successor Trustee appointed under the Indenture will signify its acceptance of such appointment by executing and delivering to the Authority and to its predecessor Trustee a written acceptance thereof, and thereupon such successor Trustee, without any further act, deed or conveyance, will become vested with all the moneys, estates, properties, rights, powers, trusts, duties and obligations of such predecessor Trustee, with like effect as if originally named Trustee in the Indenture; but, nevertheless at the Request of the Authority or the request of the successor Trustee, such predecessor Trustee will execute and deliver any and all instruments of conveyance or further assurance and do such other things as may reasonably be required for more fully and certainly vesting in and conveying to such successor Trustee all the right, title and interest of such predecessor Trustee in and to any property held by it under the Indenture and will pay over, transfer, assign and deliver to the successor Trustee any money or other property subject to the trusts and conditions set forth



in the Indenture. Upon request of the successor Trustee, the Authority will execute and deliver any and all instruments as may be reasonably required for more fully and certainly vesting in and confirming to such successor Trustee all such moneys, estates, properties, rights, powers, trusts, duties and obligations. Upon acceptance of appointment by a successor Trustee as provided in this subsection, the Authority will mail a notice of the succession of such Trustee to the trusts under the Indenture to the Bondholders at the addresses shown on the Bond registration books maintained by the Trustee. If the Authority fails to mail such notice within thirty (30) days after acceptance of appointment by the successor Trustee, the successor Trustee will cause such notice to be mailed at the expense of the Authority.

(e) Any Trustee appointed under the provisions of the Indenture will be a national banking association, a trust institution or banking institution having trust powers, doing business and having a principal corporate trust office in California or, if it will not have a principal corporate trust office in California, having the power under California law to perform all the duties of the Trustee under the Indenture as evidenced by an opinion of its counsel, having, or if it is a member of a bank holding company system its parent will have, a combined capital (exclusive of borrowed capital) and surplus of at least \$50,000,000 and subject to supervision or examination by State or federal authorities. In case at any time the Trustee will cease to be eligible in accordance with the provisions of this paragraph, the Trustee will resign immediately in the manner and with the effect specified in the Indenture.

(f) Notwithstanding anything contained in the Indenture or in the Deed of Trust to the contrary, upon the occurrence and continuance of an Event of Default, before taking any foreclosure action or any action which may subject the Trustee to liability under any Environmental Law, the Trustee may require that a satisfactory indemnity bond, indemnity or environmental impairment insurance be furnished for the payment or reimbursement of all expenses to which it may be put and to protect it against all liability resulting from any claims, judgments, damages, losses, penalties, fines, liabilities (including strict liability) and expenses which may result from such foreclosure or other action. The term "Environmental Laws" shall mean all federal, state and local environmental, land use, zoning, health, chemical use, safety and sanitation laws, statutes, ordinances and codes relating to the protection of the environment or governing the use, storage, treatment, generation, transportation, processing, handling, production or disposal of Hazardous Substances and the rules, regulations, policies, guidelines, interpretations, decisions, orders and directives of federal, state and local governmental agencies and authorities with respect thereto. The term "Hazardous Substances" shall mean any chemical, substance or material classified or designated as hazardous, toxic or radioactive, or other similar term, and now or hereafter regulated under any Environmental Law, including without limitation, asbestos, petroleum and hydrocarbon products. The Trustee shall not be required to take any foreclosure action if the approval of a government regulator shall be a condition precedent to taking such action.

*Merger or Consolidation.* Any company into which any successor Trustee may be merged or converted or with which it may be consolidated or any company resulting from any merger, conversion or consolidation to which it will be a party or any company to which the successor Trustee, if any, may sell or transfer all or substantially all of its corporate trust business, provided such company will be eligible under the immediately preceding paragraph (e), will be the successor to such successor Trustee without the execution or filing of any paper or any further act, anything in the Indenture to the contrary notwithstanding.

*Rights of Trustee.*

(a) The recitals of facts in the Indenture and in the Bonds contained will be taken as statements of the Authority, and the Trustee does not assume any responsibility for the correctness of the same, or make any representations as to the validity or sufficiency of the Indenture, the Loan Agreement or the Bonds, or incur any responsibility in respect thereof, other than in connection with the duties or

obligations in the Indenture or in the Bonds assigned to or imposed upon it. The Trustee will, however, be responsible for its representations contained in its certificate of authentication on the Bonds. The Trustee will not be liable in connection with the performance of its duties under the Indenture, except for its own negligence or willful misconduct.

(b) The Trustee will not be liable for any error of judgment made in good faith by a Responsible Officer, unless it will be proved that the Trustee was negligent in ascertaining the pertinent facts.

(c) The Trustee will not be liable with respect to any action taken or omitted to be taken by it in good faith in accordance with the direction of the Holders of not less than a majority in aggregate principal amount of the Bonds at the time Outstanding relating to the time, method and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred upon the Trustee under the Indenture. The permissive right of the Trustee to do things enumerated in the Indenture will not be construed as a duty.

(d) The Trustee will be under no obligation to exercise any of the rights or powers vested in it by the Indenture at the request, order or direction of any of the Bondholders pursuant to the provisions of the Indenture unless such Bondholders will have offered to the Trustee reasonable security or indemnity satisfactory to it against the costs, expenses and liabilities which may be incurred therein or thereby.

(e) The Trustee will not be deemed to have knowledge of any Event of Default other than an Event of Default under the Indenture in connection with principal and interest payments of any Bond unless and until it will have actual knowledge thereof, or will have received written notice thereof, at its Principal Corporate Trust Office. Except as otherwise expressly provided in the Indenture, the Trustee will not be bound to ascertain or inquire as to the performance or observance of any of the terms, conditions, covenants or agreements in the Indenture or of any of the documents executed in connection with the Bonds or as to the existence of an Event of Default under the Indenture.

(f) No provision of the Indenture will require the Trustee to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties under the Indenture, or in the exercise of its rights or powers. The Trustee has no obligation or liability to the Bondholders for the payment of interest or principal with respect to the Bonds.

(g) The Trustee will not be bound to ascertain or inquire as to the validity or genuineness of any collateral given to or held by it. The Trustee will not be responsible for the recording or filing of any document relating to the Indenture or of financing statements (or continuation statements in connection therewith) or of any supplemental instruments or documents of further assurance as may be required by law to perfect the security interests in any collateral given to or held by it.

(h) The Trustee will not be concerned with or accountable to anyone for the subsequent use or application of any moneys which will be released or withdrawn in accordance with the provisions of the Indenture.

(i) The Trustee will have the right to accept and act upon directions given pursuant to the Indenture and delivered using Electronic Notice; provided, however, that the Authority or the Borrower, as applicable, will provide to the Trustee an incumbency certificate listing authorized officers with the authority to provide such directions and containing specimen signatures of such authorized officers, which incumbency certificate will be amended whenever a person is to be added or deleted from the listing. If the Authority or the Borrower, as applicable, elects to give the Trustee directions using

Electronic Notice and the Trustee in its discretion elects to act upon such directions, the Trustee's understanding of such directions will be deemed controlling. The Authority and the Borrower understand and agree that the Trustee cannot determine the identity of the actual sender of such directions and that the Trustee will conclusively presume that directions that purport to have been sent by an authorized officer listed on the incumbency certificate provided to the Trustee have been sent by such authorized officer. The Authority and/or the Borrower, as applicable, will be responsible for ensuring that only authorized officers transmit such directions to the Trustee and that all authorized officers treat applicable user and authorization codes, passwords and/or authentication keys with extreme care. The Trustee will not be liable for any losses, costs or expenses arising directly or indirectly from the Trustee's reliance upon and compliance with such directions notwithstanding such directions conflict or are inconsistent with a subsequent written direction. The Authority and the Borrower agree: (i) to assume all risks arising out of the use of Electronic Notice to submit directions to the Trustee, including without limitation the risk of the Trustee acting on unauthorized directions, and the risk of interception and misuse by third parties; (ii) that it is fully informed of the protections and risks associated with the various methods of transmitting directions to the Trustee and that there may be more secure methods of transmitting directions than the method(s) selected by the Authority and/or the Borrower; and (iii) that the security procedures (if any) to be followed in connection with its transmission of directions provide to it a commercially reasonable degree of protection in light of its particular needs and circumstances.

(j) The Trustee will not be liable to the parties to the Indenture or deemed in breach or default hereunder if and to the extent its performance under the Indenture is prevented by reason of force majeure. The term "force majeure" means an occurrence that is beyond the control of the Trustee and could not have been avoided by exercising due care. Force majeure will include but not be limited to acts of God, terrorism, war, riots, strikes, fire, floods, earthquakes, epidemics or other similar occurrences.

(k) The Trustee may execute any of the trusts or powers of the Indenture and perform the duties required of it under the Indenture by or through attorneys, agents, affiliates, or receivers, and shall be entitled to advice of counsel concerning all matters of trust and its duty under the Indenture, and the Trustee will not be answerable for the acts or omissions of any such attorney, agent, or receiver selected by it with reasonable care.

(l) The Trustee will have no responsibility or liability with respect to any information, statements or recital in any offering memorandum or other disclosure material prepared or distributed with respect to the issuance of these Bonds.

(m) The Trustee will not be required to review or inspect, and will not be deemed to have notice of, the contents of any financial statement delivered to the Trustee under the Indenture or under any Borrower Document, it being expressly understood that the Trustee shall only receive and hold such documents as a repository for examination and copying by any Holder at such Holder's expense during business hours on Business Days with reasonable prior notice.

(n) Notwithstanding anything contained in the Indenture or in the Deed of Trust to the contrary, upon the occurrence and continuance of an Event of Default, before taking any foreclosure action or any action which may subject the Trustee to liability under any Environmental Regulation, the Trustee may require that a satisfactory indemnity bond, indemnity or environmental impairment insurance be furnished for the payment or reimbursement of all expenses to which it may be put and to protect it against all liability resulting from any claims, judgments, damages, losses, penalties, fines, liabilities (including strict liability) and expenses which may result from such foreclosure or other action. The Trustee will not be required to take any foreclosure action if the approval of a government regulator will be a condition precedent to taking such action.

(o) Whether or not therein expressly so provided, every provision of the Indenture, the Loan Agreement, the Deed of Trust, the Grant-Funded Reserve Fund Agreement or related documents relating to the conduct or affecting the liability of or affording protection to the Trustee will be subject to the provisions of the Indenture relating to the Trustee.

(p) In acting or omitting to act pursuant to the Loan Agreement, the Deed of Trust or any other document executed in connection herewith or therewith, the Trustee will be entitled to all of the rights, immunities and indemnities accorded to it under the Indenture and the Loan Agreement, including, but not limited to, under this caption “*Rights of Trustee.*”

(q) Notwithstanding the effective date of this Indenture or anything to the contrary in this Indenture, the Trustee shall have no liability or responsibility for any act or event relating to this Indenture which occurs prior to the date the Trustee formally executes this Indenture and commences acting as Trustee hereunder, which for this purpose shall be the Closing Date.

*Right of Trustee to Rely on Documents.* The Trustee will be protected in acting upon any notice, requisition, resolution, request, consent, order, certificate, report, opinion, Bond or other paper or document believed by it to be genuine and to have been signed or presented by the proper party or parties. The Trustee may consult with counsel, who may be counsel of or to the Authority, with regard to legal questions, and the opinion of such counsel will be full and complete authorization and protection in respect of any action taken or suffered by it under the Indenture in good faith and in accordance therewith. The Trustee will not be bound to recognize any person as the Holder of a Bond unless and until such Bond is submitted for inspection, if required, and his title thereto is satisfactorily established, if disputed. Whenever in the administration of the trusts imposed upon it by the Indenture the Trustee will deem it necessary or desirable that a matter be proved or established prior to taking or suffering any action under the Indenture, such matter (unless other evidence in respect thereof be specifically prescribed in the Indenture) may be deemed to be conclusively proved and established by a Certificate of the Authority, and such Certificate will be full warrant to the Trustee for any action taken or suffered in good faith under the provisions of the Indenture in reliance upon such Certificate, but in its discretion the Trustee may, in lieu thereof, accept other evidence of such matter or may require such additional evidence as it may deem reasonable.

*Preservation and Inspection of Documents.* All documents received by the Trustee under the provisions of the Indenture will be retained in its possession and will be subject at all reasonable times to the inspection of the Authority and any Bondholder, and their agents and representatives duly authorized in writing, at reasonable hours, upon reasonable notice and under reasonable conditions.

*Compensation and Indemnification of Trustee.* The Authority (solely from payments received from the Borrower) will from time to time, subject to any agreement between the Authority and the Trustee then in force, pay to the Trustee compensation for its services rendered by it in the execution of the trusts created by the Indenture and in the exercise and performance of any of the powers and duties under the Indenture of the Trustee, which compensation may not be limited by any provision of law with respect to the compensation of a trustee of an express trust, and the Authority will reimburse the Trustee for all its advances (with interest on such advances at the maximum rate allowed by law) and expenditures, including but not limited to advances to and fees and expenses of independent accountants, counsel (including in-house counsel to the extent not duplicative of other counsel’s work) and engineers or other experts employed by it, and reasonably required, in the exercise and performance of its powers and duties under the Indenture. The Authority covenants and agrees to indemnify the Trustee and its duly authorized officers, agents and employees (solely from Payments received from the Borrower) against any loss, costs, claims, suits, judgments, expense (including reasonable legal fees and expenses) and liability (other than those which are due to the Trustee’s negligence or default) which it may incur arising

out of or in the exercise and performance of its powers and duties under the Indenture, including the costs and expenses of defending against any claim of liability. The obligations of the Authority under this Section will survive resignation or removal of the Trustee under the Indenture and payment of the Bonds and discharge of the Indenture.

### **Modification of Indenture**

*Modification without Consent of Bondholders.* Subject to the conditions and restrictions contained in the Indenture, the Authority and the Trustee, from time to time and at any time, may enter into an indenture or indentures supplemental to the Indenture, which indenture or indentures thereafter will form a part of the Indenture, including, without limitation, for one or more of the following purposes, provided that the Authority and the Trustee will have received an Opinion of Bond Counsel to the effect that such amendment or modification will not cause the interest on the Tax-Exempt Bonds to be included as gross income for federal income tax purposes and that such amendment or modification is permitted by the Indenture:

(a) to add to the covenants and agreements of the Authority contained in the Indenture, other covenants and agreements thereafter to be observed, or to assign or pledge additional security for the Bonds, or to surrender any right or power in the Indenture reserved to or conferred upon the Authority; provided such amendment or modification will not materially and adversely affect the interests of the Holders of the Bonds;

(b) to make such provisions for the purpose of curing any ambiguity, inconsistency or omission, or of curing, correcting or supplementing any defective provision, contained in the Indenture, or in regard to such matters or questions arising under the Indenture as the Authority may deem necessary or desirable and not inconsistent with the Indenture; provided such amendment or modification will not materially and adversely affect the interests of the Holders of the Bonds;

(c) to modify, amend or supplement the Indenture or any indenture supplemental to the Indenture in such manner as to permit the qualification of the Indenture or thereof under the Trust Indenture Act of 1939, as amended, or any similar federal statute hereafter in effect, and, if they so determine, to add to the Indenture or any indenture supplemental to the Indenture such other terms, conditions and provisions as may be permitted by said Trust Indenture Act of 1939, as amended, or similar federal statute; provided such amendment or modification will not materially and adversely affect the interests of the Holders of the Bonds;

(d) in connection with an amendment of any agreement permitted by the Indenture for the purpose of conforming the terms, conditions and covenants of the Indenture to the corresponding or related provisions of such amended agreement;

(e) to modify or eliminate the book-entry registration system for the Bonds;

(f) to comply with requirements of a Rating Agency in order to obtain or maintain a rating on any Bonds; or

(g) in connection with the issuance of one or more Series of Additional Bonds or Refunding Bonds.

Any supplemental indenture authorized by the provisions summarized above may be executed by the Authority and the Trustee without the consent of the Holders of any of the Bonds at the time Outstanding, notwithstanding any of the provisions of the Indenture summarized under the caption “–

*Modification with Consent of Bondholders*” below, but the Trustee will not be obligated to enter into any such supplemental indenture which affects the Trustee’s own rights, duties or immunities under the Indenture or otherwise.

The Trustee will mail an executed copy of a supplemental indenture authorized by the provisions summarized above and any document related thereto or executed in connection therewith to the Borrower and each Rating Agency then rating the Bonds promptly after execution by the Authority and the Trustee. The Authority will mail drafts of any such documents to such parties prior to execution thereof.

*Modification with Consent of Bondholders.* With the consent of the Holders of not less than a majority in aggregate principal amount of the Bonds at the time Outstanding), the Authority and the Trustee may from time to time and at any time, with an Opinion of Bond Counsel to the effect that such amendment or modification will not, in and of itself, cause the interest on the Tax-Exempt Bonds to be included as gross income for federal income tax purposes, enter into an indenture or indentures supplemental to the Indenture for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the Indenture or of any supplemental indenture; provided, however, that no such supplemental indenture will (1) extend the fixed maturity of any Bonds or reduce the rate of interest thereon or extend the time of payment of interest, or reduce the amount of the principal thereof or (2) reduce the aforesaid percentage of Holders of Bonds whose consent is required for the execution of such supplemental indentures or extend the time of payment or permit the creation of any lien on the Payments or the assets pledged in the Indenture prior to or on a parity with the lien of the Indenture or deprive the Holders of the Bonds of the lien created by the Indenture upon the Payments or the assets pledged in the Indenture, without the consent of the Holders of all the Bonds then Outstanding. Upon the filing with the Trustee of evidence of the consent of Bondholders, as aforesaid, the Trustee will join with the Authority in the execution of such supplemental indenture unless such supplemental indenture affects the Trustee’s own rights, duties or immunities under the Indenture or otherwise, in which case the Trustee may in its discretion, but will not be obligated to, enter into such supplemental indenture.

It will not be necessary for the consent of the Bondholders under the provisions summarized under this caption “*–Modification with Consent of Bondholders*” to approve the particular form of any proposed supplemental indenture, but it will be sufficient if such consent will approve the substance thereof.

Promptly after the execution by the Authority and the Trustee of any supplemental indenture pursuant to the provisions summarized under this caption “*–Modification with Consent of Bondholders*,” the Authority will mail a notice to the Trustee setting forth in general terms the substance of such supplemental indenture, and the Trustee, upon receipt of such notice, will mail such notice to the Borrower and the Bondholders at the addresses shown on the Bond registration books maintained by the Trustee, at the expense of the Borrower. Any failure of the Authority or the Trustee to give such notice, or any defect therein, will not, however, in any way impair or affect the validity of any such supplemental indenture.

The Trustee will mail an executed copy of such supplemental indenture and any amendment of any agreement in accordance with the Indenture to the Borrower and each Rating Agency then rating the Bonds promptly after execution by the Authority, the Trustee, and in the case of the Loan Agreement, the Borrower. The Authority will mail drafts of any such documents to such parties prior to execution thereof.

*Effect of Supplemental Indenture.* Upon the execution of any supplemental indenture pursuant to the provisions of the Indenture will be, and will be deemed to be, modified and amended in accordance therewith, and the respective rights, duties and obligations under the Indenture of the Authority, the

Trustee and all Holders of Outstanding Bonds will thereafter be determined, exercised and enforced under the Indenture subject in all respects to such modifications and amendments, and all the terms and conditions of any such supplemental indenture will be part of the terms and conditions of the Indenture for any and all purposes.

*Opinion of Counsel as to Supplemental Indenture.* Subject to the provisions of the Indenture summarized above under “The Trustee—Right of Trustee to Rely on Documents” and the requirement described above under the captions “—Modification without Consent of Bondholders” and “—Modification with Consent of Bondholders,” for an Opinion of Bond Counsel, the Trustee and the Authority may receive an Opinion of Counsel as conclusive evidence that any supplemental indenture executed pursuant to the Indenture complies with the requirements of the Indenture and will have no liability to Holders in excluding any Supplemental Indenture in reliance on an Opinion of Bond Counsel.

*Notation of Modification on Bonds; Preparation of New Bonds.* Bonds authenticated and delivered after the execution of any supplemental indenture pursuant to the provisions of the Indenture may bear a notation, in form approved by the Authority, as to any matter provided for in such supplemental indenture, and if such supplemental indenture will so provide, new Bonds, so modified as to conform, in the opinion of the Authority, to any modification of the Indenture contained in any such supplemental indenture, may be prepared by the Authority, authenticated by the Trustee and delivered without cost to the Holders of the Bonds then Outstanding, upon surrender for cancellation of such Bonds, in equal aggregate principal amounts.

## **Miscellaneous**

*Evidence of Rights of Bondholders.* Any request, consent or other instrument required or permitted by the Indenture to be signed and executed by Bondholders may be in any number of concurrent instruments of substantially similar tenor and will be signed or executed by such Bondholders in person or by an agent or agents duly appointed in writing. Proof of the execution of any such request, consent or other instrument or of a writing appointing any such agent, or of the holding by any person of Bonds transferable by delivery, will be sufficient for any purpose of the Indenture and will be conclusive in favor of the Trustee and of the Authority if made in the manner provided in this paragraph. The fact and date of the execution by any person of any such request, consent or other instrument or writing may be proved by the certificate of any notary public or other officer of any jurisdiction, authorized by the laws thereof to take acknowledgments of deeds, certifying that the person signing such request, consent or other instrument acknowledged the execution thereof, or by an affidavit of a witness of such execution duly sworn to before such notary public or other officer. The ownership of Bonds will be proved by the bond registration books held by the Trustee. Any request, consent, or other instrument or writing of the Holder of any Bond will bind every future Holder of the same Bond and the Holder of every Bond issued in exchange therefor or in lieu thereof, in respect of anything done or suffered to be done by the Trustee or the Authority in accordance therewith or reliance thereon.

*Disqualified Bonds.* In determining whether the Holders of the requisite aggregate principal amount of Bonds have concurred in any demand, request, direction, consent or waiver under the Indenture, Bonds which are owned or held by or for the account of the Authority or the Borrower or by any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the Authority or the Borrower will be disregarded and deemed not to be Outstanding for the purpose of any such determination. In determining whether the Trustee will be protected in relying upon any such approval or consent of an Holder, only Bonds which a Responsible Officer of the Trustee actually knows to be owned or held by or for the account of the Authority or the Borrower or by any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the Authority or the Borrower will be disregarded unless all Bonds are so owned, in which case such Bonds will be

considered outstanding for the purpose of such determination. Bonds so owned which have been pledged in good faith may be regarded as Outstanding for the purposes of this paragraph if the pledgee will establish to the satisfaction of the Trustee the pledgee's right to vote such Bonds and that the pledgee is not a person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the Authority or the Borrower. In case of a dispute as to such right, any decision by the Trustee taken upon the advice of counsel will be full protection to the Trustee. Upon request of the Trustee, the Authority and the Borrower will specify in a certificate to the Trustee those Bonds disqualified and the Trustee may conclusively rely on such certificate.

*Money Held for Particular Bonds.* The money held by the Trustee for the payment of the interest, principal due on any date with respect to particular Bonds will, on and after such date and pending such payment, be set aside on its books and held in trust by it for the Holders of the Bonds entitled thereto.

*Funds and Accounts.* Any fund required by the Indenture to be established and maintained by the Trustee may be established and maintained in the accounting records of the Trustee, either as a fund or an account, and may, for the purposes of such records, any audits thereof and any reports or statements with respect thereto, be treated either as a fund or as an account; but all such records with respect to all such funds will at all times be maintained in accordance with customary standards of the corporate trust industry, to the extent practicable, and with due regard for the requirements of the Indenture (and the Tax Certificate) and for the protection of the security of the Bonds and the rights of every Holder thereof.

*Waiver of Personal Liability.* No member, officer, agent or employee of the Program Participant or the Authority will be individually or personally liable for the payment of the principal (or redemption price) of or interest on the Bonds or be subject to any personal liability or accountability by reason of the issuance thereof; but nothing in the Indenture contained will relieve any such member, officer, agent or employee from the performance of any official duty provided by law or by the Indenture.

*Governing Law; Venue.* The Indenture will be construed in accordance with and governed by the Constitution and the laws of the State applicable to contracts made and performed in the State. The Indenture will be enforceable in the State, and any action arising out of the Indenture will be filed and maintained in Sacramento County Superior Court, Sacramento County, California unless the Authority waives this requirement.

## **THE LOAN AGREEMENT**

*The Loan Agreement provides for, among other things, the loan of the Bond proceeds by the Authority to the Borrower, certain covenants of the Borrower relating to the loan and of the Project, including repayment of the loan, and defines events of default and remedies therefor.*

*Certain provisions of the Loan Agreement are set forth in this Official Statement. See "SECURITY AND SOURCES OF PAYMENT FOR THE BONDS" and "CERTAIN FINANCIAL COVENANTS OF THE BORROWER." Certain provisions of the Loan Agreement are summarized below. This summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of the Loan Agreement.*

### **Loan Financing; Loan Repayments; Indemnification; Construction Draws**

*Agreement to Issue Bonds and Application of Bond Proceeds.* In order to fund the Loan and for other purposes set forth in the Indenture, the Authority, concurrently with the execution of the Loan Agreement, will issue, sell and deliver the Bonds and direct the proceeds thereof to be deposited with the



Trustee and applied as provided in the Indenture. The Authority and the Borrower agree that the proceeds of the Bonds will be applied solely in accordance with the Indenture. The Borrower approves the terms and provisions of the Indenture and, to the extent applicable, agrees to be bound by such terms.

*The Loan; Loan Repayments; Intercept; Additional Payments.*

(a) The Loan. The Authority agrees, upon the terms and conditions specified in the Loan Agreement, to loan to the Borrower that portion of the proceeds received by the Authority from the sale of the Bonds by causing such proceeds to be deposited with the Trustee for disposition as provided in the Indenture. The obligation of the Authority to make the Loan is limited solely to such sale proceeds of the Bonds received by the Authority and shall be deemed fully discharged upon the deposit of the proceeds of the Bonds with the Trustee pursuant thereto.

(b) Loan Repayments. The Borrower will pay, or cause to be paid, from the Gross Revenues under the Lease to or upon the order of the Authority as repayment of the Loan the following amounts (which collectively constitute the “Loan Repayments”):

(i) an amount equal to the aggregate amount of interest payable by the Authority on the then Outstanding Bonds;

(ii) on or before the maturity of the Bonds, an amount equal to the principal amount of the Bonds; and

(iii) on or before any redemption date, such amounts as will, together with any other money available therefor, be sufficient to pay all amounts, if any, required to redeem the Bonds pursuant to the provisions of the Indenture, including any related redemption premium.

The Loan Repayments and all other amounts provided under this caption “*The Loan; Loan Repayments; Additional Payments,*” will be payable in such lawful money of the United States of America as at the time of payment will be legal tender for the payment of public and private debts. All deposits under the Loan Agreement will be made at the corporate trust office of the Trustee, or at such other location as will be designated in writing by the Trustee to MERF and the Borrower.

The Borrower will pay, or cause to be paid, the Loan Repayments from the Gross Revenues of the Borrower, including the Rental Payments, or from any other legally available funds of the Borrower, without any further notice thereof except as may be specifically required by the provisions under this caption “*The Loan; Loan Repayments; Additional Payments.*” The Loan Repayments payable by the Borrower under the Loan Agreement are expected to be equal in the aggregate to an amount which, together with other funds in the Revenue Fund then available for the payment of principal and interest on the Bonds, will be sufficient to provide for the payment in full of the interest on, premium, if any, and principal of the Bonds as the same become due and payable.

(c) Intercept. Simultaneously with the execution and delivery of the Bonds, the Borrower will cause the School to deliver an Intercept Notice to the State Controller pursuant to the Loan Agreement. All deposits of moneys derived from the Intercept thereunder will be made at the corporate trust office of the Trustee set forth in the Intercept Notice. The Borrower will cause the Lessee to timely revise the Intercept Notice to require transfers to such other location as will be designated in writing by the Trustee.

(d) Additional Payments. In addition to the Loan Repayments, the Borrower will also pay to the Authority or to the Trustee, as the case may be, “Additional Payments,” as follows:

(i) All taxes and assessments of any type or character charged to the Authority or to the Trustee affecting the amount available to the Authority or the Trustee from payments to be received under the Loan Agreement or in any way arising due to the transactions contemplated by the Loan Agreement (including taxes and assessments assessed or levied by any public agency or governmental authority of whatsoever character having power to levy taxes or assessments) but excluding franchise taxes based upon the capital and/or income of the Trustee and taxes based upon or measured by the net income of the Trustee; provided, however, that the Borrower will have the right to protest any such taxes or assessments and to require the Authority or the Trustee, at the Borrower's expense, to protest and contest any such taxes or assessments levied upon them and that the Borrower will have the right to withhold payment of any such taxes or assessments pending disposition of any such protest or contest unless such withholding, protest or contest would adversely affect the rights or interests of the Authority or the Trustee;

(ii) All reasonable fees, charges and expenses of the Trustee for services rendered under the Indenture and all amounts referred to in the Indenture, as and when the same become due and payable;

(iii) The reasonable fees and expenses of such accountants, consultants, attorneys and other experts as may be engaged by the Authority or the Trustee to prepare audits, financial statements, reports, opinions or provide such other services required under the Loan Agreement, the other Borrower Documents or the Indenture;

(iv) All fees and expenses of the Rating Agency, including the S&P Surveillance Fee, and the Rebate Analyst, and if a deposit is required to be made to the Rebate Fund as a result of any calculation made pursuant to the Indenture, the amount of such deposit, which will be deposited in the Rebate Fund not later than the tenth day of the calendar month immediately following the date on which such calculation was made pursuant to the Indenture;

(v) All amounts necessary for deposit into the Repair and Replacement Fund pursuant to the Indenture; and

(vi) The annual fee of the Authority and the reasonable fees and expenses of the Authority or any agent or attorney selected by the Authority to act on its behalf in connection with the Loan Agreement, the other Borrower Documents, the Bonds or the Indenture, including, without limitation, any and all reasonable expenses incurred in connection with the authorization, issuance, sale and delivery of any such Bonds or in connection with any litigation, investigation, inquiry or other proceeding which may at any time be instituted involving the Loan Agreement, the other Borrower Documents, the Bonds or the Indenture or any of the other documents contemplated thereby, or in connection with the reasonable supervision or inspection of the Borrower, its properties, assets or operations or otherwise in connection with the administration of the Loan Agreement and the other Borrower Documents.

All such payments shall be made by the Borrower from the Gross Revenues for payment to the Person or Persons entitled to such payments or for deposit to the appropriate fund or account held by the Trustee under the Indenture.

*Failure to Make Payments.* In the event the Borrower will fail to deposit, or fail to cause to be deposited, with the Trustee any Loan Repayments or Additional Payments as required by the provisions under this caption “*The Loan; Loan Repayments; Additional Payments,*” the Loan Repayments, Additional Payments or other payments required under the Loan Agreement not paid from such Gross

Revenues will continue to be an obligation under the Loan Agreement of the Borrower until the amount in default will have been fully paid.

*Obligations of Borrower Unconditional.* The Borrower will pay to or upon the order of the Authority, at or before the time when payable by the Authority, all costs and liabilities incurred by the Authority, including without limitation fees and expenses of counsel to the Authority, in connection with the issuance of the Bonds and the making of the Loan to the Borrower in the Loan Agreement, or otherwise as a result of the transactions contemplated by the Borrower Documents or the Indenture.

The obligation of the Borrower to make the payments as required in the Loan Agreement, and to perform and observe any and all of the other covenants and agreements on its part contained in the Loan Agreement, will be absolute and unconditional irrespective of any defense or any rights of setoff, recoupment, or counterclaim which the Borrower may otherwise have against the Authority, with the exception of any Intercept Payments received, which will be credited against any amounts due. The Borrower will not: (1) suspend, discontinue, or abate any payment required by the provisions under the caption “*The Loan; Loan Repayments; Additional Payments*” (except as expressly provided in the Loan Agreement); (2) fail to observe any of its other covenants or agreements in the Loan Agreement; or (3) terminate the Loan Agreement for any cause whatsoever (except as provided with prepayment of the loan under the Loan Agreement), including without limiting the generality of the foregoing, any declaration or finding that the Bonds, the Indenture, or any portion of the Loan Agreement are invalid or unenforceable, and, any failure of the Authority to perform and observe any agreement, whether expressed or implied, or any duty, liability, or obligation, arising out of or in connection with the Loan Agreement or otherwise.

Notwithstanding anything in the Loan Agreement to the contrary, the liability of the Borrower under the Loan Agreement to any person or entity, including, but not limited to, the Trustee or the Authority and their respective successors and assigns, is limited to the Gross Revenues and the amounts held in the funds and accounts created under the Indenture or under the Loan Agreement, and such persons and entities will look exclusively thereto, or to such other security as may from time to time be given for the payment of obligations arising out of the Loan Agreement or any other agreement securing the obligations of the Borrower with respect to the Loan or the Bonds.

*Deed of Trust; Assignment of Lease; Assignment of Authority's Rights.* To secure the payment of Loan Repayments and Additional Payments, the performance by the Borrower of its other obligations under the Loan Agreement, the Borrower has entered into a Deed of Trust which Deed of Trust the Borrower agrees will be recorded on or prior to the Closing Date. The Borrower agrees, as long as any of the Loan Repayments or Additional Payments remain unpaid, to supplement the Deed of Trust or to execute and deliver such other deeds of trust in substantially the form of the Deed of Trust as may be necessary from time to time to grant the Trustee a first priority Lien on the Facility owned by the Borrower in fee, subject to Permitted Liens. The Borrower will obtain, at its own cost and expense, an ALTA policy of title insurance, or an endorsement to such policy at the time of and dated as of the date of acquisition of the real property underlying the Project with a portion of the proceeds of the Bonds, in an aggregate amount not less than the aggregate principal amount of the Bonds, payable to the Trustee, insuring the title of the Borrower to the Facility owned by the Borrower in fee, subject only to Permitted Liens, issued by a title insurance company qualified to do business in the State. The Borrower will execute and cause to be filed Uniform Commercial Code financing statements, and will execute and deliver such other documents (including, but not limited to, continuation statements) as may be necessary or reasonably requested by the Authority or the Trustee (provided that the Trustee is not required to make such requests) in order to perfect or maintain as perfected such security interest or give public notice thereof.

Property will be released from the Deed of Trust if all Outstanding Bonds are redeemed pursuant to the Indenture.

As security for the payment of the Bonds, the Authority in the Indenture assigns to the Trustee certain of the Authority's rights under the Loan Agreement, including the right to receive payments under the Loan Agreement, but excluding any deposits to the Rebate Fund; and the Borrower assents to such assignment and agrees to make payments from Gross Revenues or other funds of the Borrower directly to the Trustee, without defense or set-off by reason of any dispute between the Borrower and the Authority or the Trustee. By virtue of such assignment and certain obligations of the Borrower to the Trustee, the Trustee will be a third-party beneficiary of the Loan Agreement and will have the right to enforce the obligations of the Borrower under the Loan Agreement, subject to the limitations thereof.

*Construction Draws.* The Borrower may draw the amounts from the Project Fund for construction advances subject to the requirements of the Indenture and the Loan Agreement, upon submission to the Trustee of a Requisition of the Borrower (which includes an acknowledgment by the Lessee), pursuant to the Indenture. Upon the final disbursement from the Project Fund, an Authorized Representative of the Borrower, on behalf of the Borrower, will provide a Certificate of the Borrower certifying same to the Authority and the Trustee. In the event the moneys in the Project Fund should be insufficient to pay the costs of the Project in full, the Borrower agrees to pay directly, or to deposit in the Project Fund moneys sufficient to pay, any costs of completing the Project in excess of the moneys available for such purpose in such Project Fund. The Authority makes no express or implied warranty that the moneys deposited in the Project Fund and available for payment of the Project costs under the provisions of this Loan Agreement, will be sufficient to pay all the amounts which may be incurred for such Project costs. The Borrower agrees that if, after exhaustion of the moneys in the Project Fund, the Borrower should pay, or deposit moneys in the Project Fund for the payment of, any portion of the Project costs, it will not be entitled to any reimbursement therefor from the Authority, the Trustee or the Holders of any of the Bonds, nor will it be entitled to any diminution of the amounts payable hereunder. Upon Completion of the Project, the Borrower will file with the Trustee and the Authority the Completion Certificate with respect to the Project pursuant the Indenture.

### **Maintenance, Taxes, Insurance and Condemnation**

*Maintenance and Operation of the Facility.* The Borrower will operate and maintain the Facility in accordance in all material respects with all governmental laws, ordinances, approvals, rules, regulations and requirements including, without limitation, such zoning, sanitary, pollution and safety ordinances and laws and such rules and regulations thereunder as may be binding upon the Borrower. The Borrower will maintain and operate the Facility and all engines, boilers, pumps, machinery, apparatus, fixtures, fittings and equipment of any kind in or that will be placed in any building or structure now or hereafter at any time constituting part of the Facility which are material to the operation of the Facility in good repair, working order and condition, and will from time to time make or cause to be made all needful and proper replacements, repairs, renewals and improvements so that the efficiency and value of the Facility will not be materially adversely impaired.

*Taxes, Assessments, Other Governmental Charges and Utility Charges.* The Borrower will pay and discharge all taxes, assessments, governmental charges of any kind whatsoever, water rates, meter charges and other utility charges which may be or have been assessed or which may have become liens upon the Facility or the interest therein of the Authority, the Trustee or the Holders of the Bonds, and will make such payments or cause such payments to be made, respectively, in due time to prevent any delinquency thereon or any forfeiture or sale of the Facility or any part thereof, and, upon request, will furnish to the Authority or Trustee receipts for all such payments, or other evidences satisfactory to the Authority and the Trustee; provided, however, that the Borrower will not be required to pay any tax,

assessment, rate or charge as provided in the Loan Agreement as long as it in good faith contest the validity thereof, provided that the Borrower will have set aside reserves with respect thereto that, in the commercially reasonable opinion of the governing body of the Borrower, are adequate.

*Insurance Required.*

(a) The Borrower covenants and agrees that it will keep (or cause to be kept) insurance (including builder's all-risk insurance) against loss or damage to any structure constituting any part of the Facility by fire and lightning, with extended coverage and vandalism and malicious mischief insurance. Said extended coverage insurance will, as nearly as practicable, cover loss or damage by explosion, windstorm, riot, aircraft, vehicle damage, smoke and such other hazards as are normally covered by such insurance. All insurance provided pursuant to this paragraph will be in an amount equal to the lesser of (i) one hundred percent (100%) of the replacement cost (without deduction for depreciation) of all buildings, structures and fixtures constituting any part of the Facility, or (ii) the principal amount of the Bonds then Outstanding, and will be subject to a deductible not to exceed \$100,000.

(b) The Borrower covenants and agrees to procure and maintain, throughout the term of the Loan Agreement, business interruption insurance to cover loss, total or partial, of the use of any structures constituting any part of the Facility as the result of any of the hazards covered by the insurance required by paragraph (a) above, in an amount sufficient to pay the maximum Loan Repayments under the Loan Agreement for a period of at least twelve (12) months. Proceeds of such insurance in the amount of at least twelve (12) months of maximum Loan Repayments under the Loan Agreement will be applied to Loan Repayments, in installments as the proceeds are paid to the Borrower.

(c) Subject to the provisions of the Loan Agreement relating to Workers' Disability Compensation Act, the Borrower covenants and agrees to procure and maintain at all times such other insurance on the Facility and all operations thereon (including, without limitation, liability insurance) in amounts which are customarily carried and against such risks as are customarily insured against by other corporations in connection with the ownership and operation of facilities of similar character and size to the Facility.

(d) The insurance required to be maintained pursuant to paragraph (c) above may include alternative risk management programs, including adequate self-insurance. A self-insurance program will be considered to be adequate if the Borrower is required under the program to deposit and maintain in a separate trust account, established for such purpose with a financial institution having trust powers, money in an amount sufficient, in the opinion of an independent consulting actuary, to pay claims up to the amount of the Borrower's retained liability and to pay anticipated claims expense; and

(i) The Borrower has received a report from its consulting actuary concerning its risk management program, including the Borrower's obligation to deposit money into the trust as required and such report has been filed with the Authority (if requested by the Authority) and the Trustee; the actuary must be a fellow in the Society of Actuaries; and

(ii) Such program provides for the administration and payment of claims to the extent of the Borrower's retained liability; and

(iii) Such program requires that the self-insurance plan be reviewed at least annually by an independent consulting actuary to determine the required amount of additional deposits into the trust or those amounts which the Borrower may withdraw from the trust and that a copy of the consulting actuary's annual review will be filed with the Authority (if requested by the Authority) and the Trustee; and

(iv) Such program requires that the Borrower purchase and maintain in effect excess coverage sufficient in amount so that the Borrower's retained liability and other excess coverage equals the minimum amount of coverage required under the Loan Agreement for the type of coverage as to which the Borrower intends to act or is acting as a self-insurer.

(e) An independent consultant will review the insurance requirements of the Borrower with respect to the Facility from time to time (but not less frequently than once every five years) commencing July 1, 2018. If such review indicates that the Borrower should increase any of the coverages required the Loan Agreement, the Borrower will review such recommendation with the governing body of the Borrower and will increase such coverage; provided, however, that such coverage is available from reputable insurance companies at a reasonable cost on the open market.

(f) The Borrower covenants that it will use its best efforts to apply for any grants, loans or other relief available from the State or federal government to obtain amounts necessary to rebuild any portion of the Facility destroyed or damaged in connection with an uninsured or underinsured calamity causing destruction or damage; provided, however, that the Borrower will not be required to accept such amounts if doing so would jeopardize the integrity of the Borrower's programs.

(g) The Borrower will file with the Trustee, no later than July 1 of each year, commencing July 1, 2014, a Certificate stating that the Borrower has complied with the insurance covenant under the Loan Agreement. The Trustee is entitled to rely on such Certificate as to the Borrower's compliance with the provisions of the Loan Agreement, and the Trustee will have no further duty to confirm the accuracy thereof.

*Workers' Disability Compensation Act.* The Borrower will at all times comply with the Workers' Disability Compensation Act of the State, or any successor statute or statutes.

*Insurers; Policy Forms and Loss Payees.* The insurance policies required by the Loan Agreement will be carried by insurance companies which are financially responsible and capable of fulfilling the requirements of such policies. All such policies (except liability policies) will name the Borrower and the Trustee as insured parties, beneficiaries or loss payees as their interest may appear. Each policy will be in such form and contain such provisions as are generally considered standard for the type of insurance involved and will contain a provision to the effect that the insurer will not cancel or substantially modify the policy provisions without first giving at least thirty (30) days written notice thereof to the Borrower and the Trustee. In lieu of separate policies, the Borrower may maintain blanket policies which cover any one or more risks required to be insured against so long as the minimum coverages required in the Loan Agreement are met.

*Disposition of Insurance and Condemnation Proceeds.*

(a) All proceeds of the insurance carried pursuant to paragraph (a) under "*Insurance Required*" above (except proceeds of the liability portion, if any, of such insurance), and proceeds of any condemnation awards with respect to the Facility will be paid immediately upon receipt by the Borrower or other named insured parties to the Trustee for deposit in a special fund which the Trustee will establish and maintain and hold in trust pursuant to the Indenture, to be known as the "Insurance and Condemnation Proceeds Fund." In the event the Borrower elects to repair or replace the portion of the Facility damaged, destroyed or taken, moneys in the Insurance and Condemnation Proceeds Fund will be disbursed by the Trustee, after deducting therefrom the reasonable charges and expenses of the Trustee incurred in connection with the collection and disbursement of such moneys, for the purpose of repairing or replacing the portion of the Facility damaged, destroyed or taken in the manner and subject to the

conditions set forth in the Indenture with respect to disbursements from the Insurance and Condemnation Proceeds Fund.

(b) If the Borrower will elect not to, or cannot, repair or replace the portion or portions of the Facility damaged, destroyed or taken, as provided in paragraph (a) above, subject to paragraph (c) below, the Trustee will transfer all amounts in the Insurance and Condemnation Proceeds Fund on account of such damage, destruction or condemnation to the Special Redemption Account established in the Indenture.

(c) If all amounts in the Insurance and Condemnation Proceeds Fund are not sufficient to retire all Bonds then Outstanding, the Trustee will not transfer said amounts to the Special Redemption Account unless the Borrower will file with the Trustee a report of an independent consultant showing that net operating income of the School at the Facility is projected to be at least equal to amounts due under the Lease for each of the three full Fiscal Years immediately following such transfer, after giving effect to the retirement of such Bonds. In the event such report of an independent consultant shows that projected net operating income of the School at the Facility will not be sufficient to pay amounts due under the Lease for each of the three full Fiscal Years immediately following such transfer, after giving effect to the retirement of such Bonds, the Borrower will apply all amounts in the Insurance and Condemnation Proceeds Fund to the repair or replacement of the portion or portions of the Facility damaged, destroyed or taken, as provided in paragraph (a) above.

*Construction Authorization and Permits.* The Borrower will obtain all authorizations and permits relating to construction of the Project that are necessary to complete the Project from all applicable governmental authorities.

*Lease.* If any Bonds are Outstanding, the Borrower may not voluntarily terminate the Lease prior to completion of its stated terms nor amend the Lease to result in an earlier end of its stated term; provided nothing in this paragraph limits the exercise of any remedy provided in the Lease in the event of default by the Lessee.

*Ownership or Lease of the Project and the Facility.* The Borrower agrees that it will own the Project during the term of this Loan Agreement, except that the Borrower may dispose of any component of the Project if the age of such component exceeds the useful life of such component. The Borrower will not lease the Facility as lessor except pursuant to the Lease.

## **Additional Covenants and Agreements of Borrower**

### *Tax Covenants.*

(a) It is the intention of the Borrower that interest on the Tax-Exempt Bonds will be and remain excluded from the gross income of the Beneficial Owners thereof for federal income tax purposes, and to that end the covenants and agreements of the Borrower summarized in this caption “*Tax Covenants*” and in the Tax Certificate are for the benefit of the Trustee on behalf of and for each and every Beneficial Owner of the Tax-Exempt Bonds.

(b) The Borrower covenants and agrees that it will not use or permit the use of any of the funds provided by the Authority under the Loan Agreement or any other funds of the Borrower, directly or indirectly, or direct the Trustee to invest any funds held by it under the Loan Agreement or under the Indenture, in such manner as would, or enter into, or allow any “related person” (as defined in Section 147(a)(2) of the Code) to enter into, any arrangement, formal or informal, for the purchase of the Tax-Exempt Bonds that would, or take or omit to take any other action that would cause any Tax-Exempt

Bond to be an “arbitrage bond” within the meaning of Section 148 of the Code or “federally guaranteed” within the meaning of Section 149(b) of the Code and applicable regulations promulgated from time to time thereunder.

(c) In the event that at any time the Borrower is of the opinion or becomes otherwise aware, including from the School, that for purposes of the provisions the Loan Agreement and the Indenture regarding tax covenants, it is necessary to restrict or to limit the yield on the investment of any moneys held by the Trustee under the Indenture, the Borrower will determine the limitations and so instruct the Trustee in writing and cause the Trustee to comply with those limitations under the Indenture. The Borrower will take such action or actions as may be reasonably necessary in the opinion of Bond Counsel, or of which it otherwise becomes aware, to comply fully with Section 148 of the Code.

(d) The Borrower will not, pursuant to an arrangement, formal or informal, purchase Tax-Exempt Bonds in an amount related to the amount of the Loan, except as otherwise permitted under the Indenture.

(e) In order to maintain the exclusion of interest on the Tax-Exempt Bonds from the gross income of the owners thereof for federal income purposes and to assure compliance with the laws of the State, the Borrower agrees that it will, concurrently with or before the execution and delivery of the Tax-Exempt Bonds, execute and deliver the Tax Certificate, and will comply with every term of the Tax Certificate. The Borrower covenants with the Authority, for the benefit of the Owners of the Tax-Exempt Bonds from time to time outstanding, that so long as any Tax-Exempt Bonds remain Outstanding, moneys on deposit in any fund, or account in connection with the Tax-Exempt Bonds, whether or not such moneys were derived from the proceeds of the sale of the Tax-Exempt Bonds or from any other sources, and moneys pledged directly or indirectly to the payment or for the securing of the Tax-Exempt Bonds, will not be used by or for the Borrower in a manner that will cause the Tax-Exempt Bonds to be “arbitrage bonds” within the meaning of Section 148 of the Code. The Borrower expressly recognizes that, to the extent required by Section 148 of the Code, “proceeds” of the Tax-Exempt Bonds (including investment proceeds and “replacement” proceeds) may be required to be invested at a yield not exceeding the yield on the Tax-Exempt Bonds in order to comply with this Section. In furtherance of the covenant in this Section, the Borrower agrees that it will not direct any investments or reinvestments that would contravene either the investment representations made by the Authority in the Tax Certificate or any investment directions provided by the Authority and deemed reasonably necessary in the opinion of Bond Counsel to preserve the exclusion from gross income of interest on the Tax-Exempt Bonds for federal income tax purposes.

(f) In the event of any conflict between the terms of the Loan Agreement and the requirements of the Tax Certificate, the Tax Certificate will control.

*Continuing Disclosure.* The Borrower covenants and agrees that it will comply with and carry out all of the provisions of the Continuing Disclosure Agreement. Notwithstanding any other provision of the Loan Agreement or the Indenture, failure of the Borrower or the Dissemination Agent (as defined in the Continuing Disclosure Agreement) to comply with the Continuing Disclosure Agreement will not be considered an Event of Default under the Loan Agreement or under the Indenture.

*Financial Covenants.* The Borrower covenants:

- (a) To maintain books and records separate from any other person or entity;
- (b) To maintain its accounts separate from any other person or entity;



- (c) Not to commingle assets with those of any other entity;
- (d) To conduct its own business in its own name;
- (e) To maintain financial statements separate from those of the Lessee;
- (f) To pay its own liabilities out of its own funds;
- (g) To observe all corporate formalities;
- (h) To maintain an arm's-length relationship with its affiliates;
- (i) To pay the salaries of its own employees and maintain a sufficient number of employees in light of its contemplated business operations;
- (j) Not to guarantee or become obligated for the debts of any other entity or hold out its credit as being available to satisfy the obligations of others;
- (k) Not to acquire obligations or securities of its partners, members, or shareholders;
- (l) To allocate fairly and reasonably any overhead for shared office space;
- (m) To use stationery, invoices, and checks separate from those of the Lessee;
- (n) Not to pledge its assets for the benefit of any other entity or make any loans or advances to any entity;
- (o) To hold itself out as an entity separate from the Lessee;
- (p) To correct any known misunderstanding regarding its separate identity; and
- (q) To maintain adequate capital in light of its contemplated business operations, including but not limited to its contemplated business operations in connection with the Project.

*Employee Benefit Plan Covenant.* The Borrower will continue to make all required contributions to all employee benefit plans, if any, and the Borrower has no knowledge of any material liability which has been incurred by itself and remains unsatisfied for any taxes or penalties with respect to any employee benefit plan or any multi employer plan, and each such plan has been administered in compliance with its terms and the applicable provisions of ERISA and any other federal or state law.

*Prohibited Uses.* No portion of the proceeds of the Tax-Exempt Bonds will be used to finance or refinance any facility, place or building to be used (1) primarily for sectarian instruction or study or as a place for devotional activities or religious worship or (2) by a person that is not a 501(c)(3) Organization or a Governmental Unit or by a 501(c)(3) Organization (including the Borrower and the Lessee) in an "unrelated trade or business" (as set forth in Section 513(a) of the Code), in such a manner or to such extent as would result in any of the Bonds being treated as an obligation not described in Section 103(a) of the Code.

*Limitation on Disposition of Property, Plant and Equipment and the Project.* The Borrower covenants and agrees that it will not sell or otherwise dispose, including any disposition by lease, of the Property, Plant and Equipment consisting of all or any part of the Facility, except for disposition or transfers:

- (a) Of Property, Plant and Equipment no longer necessary for the operation of the Facility;
- (b) Of Property, Plant and Equipment replaced by Property, Plant and Equipment of similar type and/or of substantially equivalent function with a substantially equivalent value; or
- (c) Of Property, Plant and Equipment sold or disposed of at a price equal to their fair market value.

In addition to the foregoing limitations, the Borrower may not sell, lease or otherwise dispose (other than with respect to the public dedication in connection with the development of the Project) of any Property unless it will be established to the satisfaction of the Trustee that (i) the security of the Deed of Trust and the ability of the trustee thereunder to foreclose upon the remaining Property will not be impaired as a result of the disposition of such property, and (ii) the Borrower will have conveyed to the trustee under the Deed of Trust such rights-of-way, easements and other rights in land as are required for ingress to and egress from the remaining Property, for the utilization of the facilities located thereon and for utilities required to serve such facilities.

The Borrower may not cause or permit any portion of the Facility that is part of the Project to be used or operated in any manner except in conjunction with a school under the Charter School Law.

*Sufficiency of Rental Payments.* The Borrower has confirmed in the Loan Agreement that its Gross Revenues are expected to be made in an amount sufficient (without any other borrowing) to pay all Loan Repayments. The Borrower agrees to fix, charge and collect, or cause to be fixed, charged and collected, rental rates, fees and charges for the use of the Facility such that the Debt Service Coverage Ratio at the end of each Fiscal Year is not less than 1.10:1.00. If the Debt Service Coverage Ratio falls below 1.00:1.00, it will constitute an Event of Default under the Loan Agreement.

*Limited Purpose of the Borrower; Limitations on Additional Debt; Permitted Liens.*

(a) The Borrower agrees that it is organized and operated for the sole purpose of owning the Facility and that it will not engage in any other business activity or incur any obligations or liabilities other than those associated with the Lease or executed by it.

(b) The Borrower will not incur, or cause the School to incur, any additional indebtedness secured in whole or in part by Liens on the Facility and the Gross Revenues of the School, that are senior to the Deed of Trust and the security interest in the Gross Revenues.

(c) The Borrower will not incur, or cause the School to incur, any additional indebtedness secured on a parity with the Bonds and in whole or in part by Liens on the Facility or the Gross Revenues (with the exception of the securing of alternate financing that contemporaneously pays in full all obligations of the Borrower under the Loan Agreement and of the School under the Lease); provided that the Borrower may incur additional parity indebtedness in connection with the issuance of Additional Bonds or Refunding Bonds pursuant to the Indenture, if the Borrower has delivered evidence to the Trustee that the Debt Service Coverage Ratio for the preceding Fiscal Year was equal to or greater than 1.2 to 1 and that the projected Debt Service Coverage Ratio for the Fiscal Year in which such additional parity indebtedness will be incurred and for one subsequent Fiscal Year, taking into account the additional indebtedness, will be equal to or greater than 1.2 to 1. The Borrower also acknowledges and agrees that it is subject to and will be required to satisfy any additional requirements of the Indenture relative to the issuance of Additional Bonds or Refunding Bonds.

(d) The Borrower covenants that except as specifically provided in the Loan Agreement, the Borrower will not create, assume, incur or suffer to be created, assumed or incurred any Lien other than Permitted Liens. The Borrower may incur Indebtedness subordinate to the obligations of the Borrower under the Loan Agreement and may create Liens on the Facility and the Gross Revenues, or other assets of the Borrower securing such subordinate Indebtedness, so long as such Indebtedness is (i) subordinate to the Deed of Trust and obligations under the Loan Agreement and (ii) incurred by the Borrower in the ordinary course of business and does not exceed \$1,000,000.

## **Defaults and Remedies**

*Events of Default.* Any one of the following which occurs and continues will constitute an Event of Default under the Loan Agreement:

- (a) failure by the Borrower to pay or cause to be paid the Loan Repayments when due, or
- (b) failure by the Borrower to pay or cause to be paid when due any other amounts required to be paid under the Loan Agreement and continuation of such failure to pay for ten (10) Business Days following the giving of written notice thereof to the Borrower; or
- (c) failure of the Borrower to observe and perform any covenant, condition or agreement on its part to be observed or performed under the Loan Agreement (other than failure by the Borrower to pay the amounts required to be paid under the Loan Agreement, as referred to in paragraphs (a) or (b) above, and other than as provided in paragraph (d) below) after the Borrower will have been given 30 days' written notice specifying such default and requesting it be remedied, unless the Trustee will have consented to an extension beyond such 30-day period which extension will not exceed 90 days; provided that the Borrower will have commenced cure and be diligently pursuing cure in good faith; or
- (d) voluntary initiation by the Borrower of any proceeding under any federal or state law relating to bankruptcy, insolvency, arrangement, reorganization, readjustment of debt or any other form of debtor relief, or the initiation against the Borrower of any such proceeding that will remain undismissed for 60 calendar days, or failure by the Borrower to promptly have discharged any execution, garnishment or attachment of such consequence as would impair the ability of the Borrower to carry on its operations, or assignment by the Borrower for the benefit of creditors, or the entry by the Borrower into an agreement of composition with creditors or the failure generally by the Borrower to pay its debts as they become due;
- (e) occurrence and continuance of an "Event of Default" under the Indenture or any of the Borrower Documents, provided, however, that an Event of Default under the Indenture arising solely from the actions or inactions of the Authority or the Trustee will not be an Event of Default under the Loan Agreement; or
- (f) any representation or warranty made in the Loan Agreement or any statement or representation made by the Borrower in any certificate, report, opinion, financial statement or other instrument furnished in connection with the Loan or any of the Borrower Documents proves to be false or misleading in any material respect when made.

### *Remedies.*

- (a) Upon the occurrence of an Event of Default described above and at any time thereafter during the continuance of such Event of Default, the Trustee, subject to the Trustee's right and protections under the Indenture, may take one or more or any combination of the following remedial steps:

(i) By written notice to the Borrower, declare the unpaid indebtedness on the Bonds and all amounts then due and payable under the Loan Agreement, whether by acceleration of maturity or otherwise, to be immediately due and payable, whereupon the same will become immediately due and payable; and

(ii) Take whatever action at law or in equity may appear necessary or desirable to collect the amounts then due and thereafter to become due under the Loan Agreement, or to enforce performance and observance of any obligation, agreement or covenant of the Borrower under the Loan Agreement, the Bonds or any other Borrower Document.

Any amounts collected pursuant to action taken by the Trustee under paragraph (a) will be applied in accordance with provisions of the Indenture. Notwithstanding anything in the Loan Agreement to the contrary, the indebtedness of the Borrower under the Loan Agreement may be separately and independently accelerated with or without an acceleration of the Bonds.

(b) If the Trustee will have proceeded to enforce the rights of the Authority under the Loan Agreement and such proceedings will have been discontinued or abandoned for any reason or will have been determined adversely to the Trustee or the Authority, then the Borrower, the Trustee and the Authority will be restored respectively to their several positions and rights under the Loan Agreement, and all rights, remedies and powers of the Borrower, the Authority and the Trustee will continue as though no such proceedings had taken place.

*Additional Remedies.* In addition to the above remedies, if an Event of Default occurs under the Loan Agreement, the Authority and the Trustee will have the right and remedy, without posting bond or other security, to have the provisions of the Loan Agreement specifically enforced by any court having equity jurisdiction, it being acknowledged and agreed that any such breach will cause irreparable injury to the Trustee and the Authority and that money damages will not provide an adequate remedy thereto.

## **Prepayment**

### *Prepayment of the Loan.*

(a) *General.* As further described below, the Borrower will have the right, so long as all amounts which have become due under the Loan Agreement have been paid, at any time or from time to time to prepay all or any part of its Loan Repayments and the Authority agrees that the Trustee will accept such prepayments when the same are tendered. Prepayments may be made by payments of cash or surrender of Bonds. All such prepayments (and the additional payment of any amount necessary to pay the applicable redemption price, if any, payable upon the redemption of Bonds) will be deposited upon receipt in the applicable account of the Redemption Fund and, at the request of and as determined by the Borrower, credited against payments due under the Loan Agreement or used for the redemption of Outstanding Bonds in the manner and subject to the terms and conditions set forth in the provisions of the Indenture regarding optional redemption and special redemption. The Borrower also will have the right to surrender Bonds acquired by it in any manner whatsoever to the Trustee for cancellation, and such Bonds, upon such surrender and cancellation, will be deemed to be paid and retired. Notwithstanding any such prepayment or surrender of Bonds, as long as any Bonds remain Outstanding or any Additional Payments required to be made under the Loan Agreement remain unpaid, the Borrower will not be relieved of its obligations under the Loan Agreement.

(b) *Prepayment in Whole or in Part.* The Loan may be prepaid in whole or in part at any time by delivering to the Trustee amounts sufficient to defease a like principal amount of Bonds to their

optional redemption date pursuant to the provisions of the Indenture regarding optional redemption, special redemption and defeasance.

(c) *Prepayment in Whole or in Part from Amounts Transferred from Insurance and Condemnation Proceeds.* The Loan may be prepaid in whole or in part at any time in a principal amount corresponding to amounts transferred from the Insurance and Condemnation Proceeds Fund pursuant to the Indenture and used to redeem Bonds at the option of the Borrower pursuant to the Indenture.

(d) *Prepayment in Part from Amounts Transferred from Project Fund.* The Loan may be prepaid in part at any time in a principal amount corresponding to amounts transferred from the Project Fund pursuant to the Loan Agreement and used to redeem Bonds at the option of the Borrower pursuant to the Indenture.

(e) *Prepayment in Whole upon Charter School Ceasing to Operate in the Facility.* The Loan may be prepaid in whole at any time if the Borrower delivers a certificate to the Trustee to the effect that there has ceased to operate a charter school under the Charter School Law at the Facility, and upon by delivery to the Trustee for deposit in the Redemption Fund of amounts sufficient to defease the Bonds. The Bonds shall be redeemed pursuant to the Indenture.

*Redemption of Bonds Upon Prepayment.* Upon prepayment of the Loan as provided in under the caption “*Prepayment of the Loan*,” the Trustee will do any of the following, as applicable: (1) call all or part of the Bonds for redemption, as required by the Indenture in the respective amounts set forth in the applicable paragraph of the provisions of the Indenture regarding optional redemption and special redemption, and (2) provide for the defeasance of Bonds pursuant to the Indenture.

*Amount of Prepayment.* In the event of any prepayment pursuant to the provisions of the Loan Agreement summarized under the caption “*Prepayment of the Loan*,” the amount of the Loan deemed to be prepaid will be equal to the principal amount of Bonds defeased or redeemed as described in the provisions of the Indenture regarding optional redemption and special redemption. In the case of prepayment of the Loan in full, the Borrower will pay to the Trustee an amount sufficient, together with other funds held by the Trustee and available for such purpose, to pay all reasonable and necessary fees and expenses (including attorneys’ fees) of the Authority, the Trustee and any paying agent accrued and to accrue through final payment of the Bonds and all other liabilities of the Borrower accrued and to accrue under the Loan Agreement and will pay to the Authority an amount required by the Loan Agreement. In the case of partial prepayment of the Loan, the Borrower will pay or cause to be paid to the Trustee an amount sufficient, together with other funds held by the Trustee and available for such purpose, to pay expenses of redemption of the Bonds to be redeemed upon such prepayment.

The Borrower agrees that it will not prepay the Loan or any part thereof, except in amounts sufficient to redeem Bonds in Authorized Denominations.

## **Miscellaneous**

*Amendments; Modifications in Writing.* Except as otherwise provided in the Loan Agreement or the Indenture, subsequent to the initial issuance of Bonds and prior to their payment in full, or provision for such payment having been made as provided in the Indenture, the Loan Agreement may be effectively amended, changed, modified, altered or terminated only as permitted under the Indenture, by written instrument executed by the parties to the Loan Agreement. The Authority agrees that it will not consent to an amendment of the Indenture without the approval of the Borrower.

*Waiver of Personal Liability.* No member, officer, agent or employee of the Borrower, the Sole Member or the School or of the Authority will be individually or personally liable for the payment of any principal (or redemption price) or interest on the Bonds or any sum under the Loan Agreement or be subject to any personal liability or accountability by reason of the execution and delivery of the Loan Agreement; but nothing contained in the Loan Agreement will relieve any such member, director, officer, agent or employee from the performance of any official duty provided by law or by the Loan Agreement.

## **THE DEED OF TRUST**

*Certain provisions of the Deed of Trust are summarized below. This summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of the Deed of Trust.*

### **Definitions**

For purposes of the Deed of Trust: “Trustor” means MPM Sherman Way LLC; “Trustee” means the Title Company; and “Beneficiary” means the holder or issuers from time to time of Bonds and The Bank of New York Mellon Trust Company, N.A. as bond trustee (the “Bond Trustee”). Other definitions particular to the Deed of Trust are contained below.

### **Grant in Trust**

Trustor grants and assigns to Trustee, in trust, with power of sale and right of entry and possession, all of Trustor’s right, title and interest owned in certain real property located in the County of Los Angeles, State of California (the “Site”), together with all of the Trustor’s right, title and interest, whether now owned or hereafter acquired, in or to the property and rights listed in paragraphs (a) through (h) below (for purposes of the Deed of Trust, collectively referred to as the “Property”):

(a) All buildings, structures, fixtures, additions, enlargements, extensions, modifications, repairs, replacements and improvements located on the Site (the “Improvements”); and to the extent permitted by law, the name or names, if any, as may now or hereafter be used for each Improvement;

(b) All easements, rights-of-way, strips and gores of land, streets, ways, alleys, passages, sewer rights, water, water courses, water rights and powers, air rights and development rights, liberties, tenements, hereditaments and appurtenances of any nature whatsoever, in any way belonging, relating or pertaining to the Site or the Improvements and the reversions, remainders, and all land lying in the bed of any street, road or avenue, opened or proposed, in front of or adjoining the Site to the center line thereof and all the estates, rights, titles, interests, property, possession, claim and demand whatsoever, both in law and in equity, of Trustor of, in and to the Site and the Improvements and every part and parcel thereof, with the appurtenances thereto;

(c) All machinery, equipment, fixtures (including, but not limited to, all heating, air conditioning, plumbing, lighting, communications and elevator fixtures), inventory and articles of personal property and accessions thereof and renewals, replacements thereof and substitutions therefor, and other tangible property of every kind and nature whatsoever owned by Trustor, or in which Trustor has or will have an interest, located upon the Site or used in connection with the operation and occupancy of the Site or the Improvements;

(d) All awards of payments, including interest thereon, which may be made with respect to the Property to the extent actually received by Trustor, whether from the exercise of the right of eminent domain (including, but not limited to, any transfer of the Property or part thereof made in lieu of or in

anticipation of the exercise of said right), or for any other injury to or decrease in the value of the Property;

(e) All leases and other agreements affecting the use, enjoyment or occupancy of the Property now or hereafter entered into (the “Leases”) and all oil and gas or other mineral royalties, bonuses and rents, revenues, security deposits, issues and profits from the Property (the “Rents”) and all proceeds from the sale or other disposition of the Leases and the right to receive and apply the Rents to the payment of the obligations secured by the Deed of Trust;

(f) All proceeds of and any unearned premiums on any insurance policies covering the Property including, without limitation, the right to receive and apply the proceeds of any insurance, judgments (including with respect to a casualty thereto or condemnation thereof), or settlements made in lieu thereof, for damage to the Property;

(g) The right, in the name and on behalf of Trustor, to appear in and defend any action or proceeding brought with respect to the Property and to commence any action or proceeding to protect the interest of Beneficiary in the Property; and

(h) All right, title and interest of every nature of the Trustor in all receivables and other accounts of Trustor relating to the Property and in all monies deposited or to be deposited in any funds or account maintained or deposited with Beneficiary in connection therewith, if any.

### **Assignment of Rents**

Trustor absolutely and irrevocably assigns to Beneficiary the Rents of the Property upon the terms and conditions set forth in the Deed of Trust. This assignment will not impose upon Beneficiary any duty to produce Rents from the Property, and said assignment will not cause Beneficiary to be a “mortgagee in possession” for any purpose. This assignment of the Rents and profits of the Property is intended to be an absolute assignment from Trustor to Beneficiary and not merely the passing of a security interest. Beneficiary is authorized to collect and receive the foregoing Rents, to give proper receipts and acquittances therefor and to apply the same to the payment of the obligations secured thereby. However, Beneficiary grants Trustor a revocable license to collect and receive, and to use in accordance with the provisions of the Indenture, such Rents until after an Event of Default (as that term is defined in the Deed of Trust) has occurred and while such Event of Default is continuing. Upon an Event of Default, the license will be automatically revoked and, without the necessity of Beneficiary entering upon and taking and maintaining full control of the Property in person, by agent or by a court appointed receiver, Beneficiary will immediately be entitled to possession of all Rents of the Property as the same will become due and payable, including, but not limited to, Rents then due and unpaid. All such Rents thereafter collected by Trustor will be held by Trustor as trustee in a constructive trust for the benefit of Beneficiary only. Trustor agrees that commencing upon delivery of such written notice of revocation of license, each tenant of the Property will make such Rents payable to and pay such Rents to Beneficiary or Beneficiary’s agents on Beneficiary’s written demand to each tenant, without any liability on the part of said tenant to inquire further as to the existence of a default or license by Trustor.

### **Obligations Secured**

Trustor makes the foregoing grant for the purpose of securing:

(a) Payment to the Authority of all Loan Repayments and Additional Payments and other amounts to be paid by Trustor arising under the Loan Agreement;

(b) The observance and performance by Trustor of each covenant and obligation on the part of Trustor to be observed or performed pursuant to the Loan Agreement (as amended, supplemented or otherwise modified from time to time referred to collectively with the Indenture, as the “Financing Documents”);

(c) The payment of all payments required with respect to Bonds issued or executed and delivered from time to time by the Trustor and the performance by Trustor of each covenant and obligation on part of Trustor to be observed or performed pursuant to the agreements and instruments pursuant to which such Bonds is issued or executed and delivered;

(d) The observance and performance of each covenant and obligation of Trustor contained or incorporated in the Deed of Trust by reference and payment of each fee, cost and expense by Trustor as set forth in the Deed of Trust; and

(e) Payment of such further sums and performance of such further obligations as the then record owner of the Property may undertake to pay and perform for the benefit of Beneficiary, its successors or assigns, when said borrowing or obligation is evidenced by a writing signed by such owner reciting that it or they are so secured.

### **Certain Rights and Duties of the Parties**

Title. Trustor warrants that it lawfully holds and possesses the real property described in the Deed of Trust, in fee simple, free and clear of all liens, encumbrances and other exceptions, other than the Permitted Liens, and without limitation on the right to encumber except as set forth in the Loan Agreement.

Liens and Encumbrances. Except as permitted by the Financing Documents, Trustor will pay, when due at or prior to maturity or such other period as permitted in the Loan Agreement, all obligations secured by or reducible to liens and encumbrances which encumber the Property or any part thereof or interest therein, whether senior or subordinate hereto, including without limitation all claims for work or labor performed, or materials or supplies furnished, in connection with any work of demolition, alteration, improvement of or construction upon the Property. Trustor has the right to contest in good faith any such obligation or claim provided such contest is prosecuted diligently and in a manner not prejudicial to Beneficiary, and if a judgment adverse to Trustor is obtained, such judgment will be fully paid or discharged within ten (10) days after the entry of such judgment unless such judgment is stayed. Upon demand by Beneficiary, Trustor will defend, indemnify and hold Beneficiary harmless against any such obligation or claim, so contested by Trustor, and upon demand by Beneficiary, Trustor will make suitable provision by payment to Beneficiary or by posting a bond or other security satisfactory to Beneficiary for the possibility that the contest will be unsuccessful, including, if Beneficiary requests, a one and one half times bond with respect to mechanics’ or materialmens’ liens, if available. Such provision will be made within ten (10) days after demand therefor and, if made by payment of funds to Beneficiary, the amount so deposited will be disbursed in accordance with the resolution of the contest either to Trustor or the adverse claimant. If Trustor fails to post a suitable bond or other acceptable security as provided, Beneficiary may remove or pay such lien or encumbrance at Trustor’s expense.

Maintenance and Preservation of the Property. Trustor covenants: (i) to maintain or cause to be maintained the Property in good condition and repair; (ii) to pay when due all claims for work performed and for materials furnished on or to the Property to the extent required by the Financing Documents and which are not otherwise being contested by the Trustor in good faith, and to pay within the periods permitted in the Financing Documents any and all liens or encumbrances arising out of or resulting from work performed or materials supplied on or to the Property to the extent required by the Financing



Documents; (iii) to comply in all material respects with and not suffer material violations of, (a) any and all laws, ordinances and regulations (“Laws”), (b) any and all covenants, conditions, restrictions and equitable servitudes (“Covenants”), and (c) all requirements of insurance companies (“Requirements”), which Laws, Covenants or Requirements affect the Property and pertain to acts committed or conditions existing thereon, including without limitation such work of alteration, improvement or demolition as such Laws, Covenants or Requirements mandate; (iv) not to commit or permit waste of the Property; (v) to do all other acts which from the character or use of the Property may be reasonably necessary to maintain and preserve its value; (vi) to perform all material obligations required to be performed in leases, conditional sales contracts or like agreements affecting the Property or the operation, occupation or use thereof; (vii) not to create any deed of trust or encumbrance upon the Property other than Permitted Liens; (viii) to make no further assignment of Rents of the Property other than Permitted Liens; and (ix) to execute and, where appropriate, acknowledge and deliver such further instruments as Beneficiary or Trustee reasonably deems necessary or appropriate to preserve, continue, perfect and enjoy the security provided for herein, including without limitation assignments of Trustor’s interest in the leases of the Property.

Collection of Rents. Subject to the provisions of the Financing Documents, Beneficiary confers upon Trustor the authority to collect and retain Rents of the Property as they become due and payable; provided, however, that Beneficiary may revoke said authority and collect and retain the Rents of the Property assigned herein to Beneficiary upon the occurrence and continuance of an Event of Default (as that term is defined in the Deed of Trust) by Trustor upon giving written notice to Trustor, and without regard to the adequacy of any security for the indebtedness hereby secured, and without taking possession of all or any part of the Property or becoming a “mortgagee in possession.” The right to collect Rents as provided in the Deed of Trust will not grant to Beneficiary or Trustee the right to possession, except as expressly therein provided; nor will said right impose upon Beneficiary or Trustee the duty to produce Rents or profits or maintain the Property in whole or in part. Trustor agrees that it will do nothing to impair Beneficiary’s ability to collect and retain the Rents and interests herein assigned on the terms hereof and that any tenant or subtenant occupying the Property or any part thereof may pay any and all Rents or other charges directly to Beneficiary upon notice from Beneficiary without the necessity of any notice from Trustor. Beneficiary may apply, in its sole discretion, any Rents, so collected by Beneficiary against any indebtedness secured hereby or any obligations of Trustor arising hereunder or any other obligations of Trustor to Beneficiary, whether existing or hereafter arising. Collection of any Rents by Beneficiary will not cure or waive any default or notice of default hereunder or invalidate any acts done pursuant to such notice.

Powers of Trustee. From time to time upon the written request of Beneficiary and presentation of the Deed of Trust for endorsement, Trustee may (i) reconvey all or any part of the Property, (ii) consent to the making of any map or plat thereof, (iii) join in granting any easement thereon, (iv) join in any declaration of covenants and restrictions, or (v) join in any extension agreement or any agreement subordinating the lien or charge hereof. Trustee will, upon request by Trustor, consent to utility easements, subdivision maps and similar rights in the Property granted or applied for by Trustor, provided that rights granted or applied for (a) are customary in connection with the development of real property, (b) are reasonable in form and content, and (c) do not materially and adversely diminish the value of the Property. Trustee or Beneficiary may from time to time apply to any court of competent jurisdiction for aid and direction in the execution of the trusts under the Deed of Trust and the enforcement of the rights and remedies available thereunder, and Trustee or Beneficiary may obtain orders or decrees directing or confirming or approving acts in the execution of said trusts and the enforcement of said remedies. Trustee has no obligation to notify any party of any pending sale or any action or proceeding unless held or commenced and maintained by Trustee under the Deed of Trust. Trustor will pay to Trustee reasonable compensation and rents for services and expenses in the administration of the trusts created hereunder upon the occurrence of an Event of Default, including reasonable attorneys’ fees. Trustor

indemnifies Trustee and Beneficiary against all losses, claims, demands and liabilities (except losses, claims, demands or liabilities arising from the negligence or willful misconduct of the indemnified party) which may be incurred, suffered or sustained in the execution of the trusts created hereunder or in the performance of any act required or permitted under the Deed of Trust or by law.

Reconveyance. Upon Beneficiary's written request, and upon surrender to Trustee for cancellation of the Deed of Trust and a copy of the instrument or instruments setting forth all obligations secured hereby, Trustee will reconvey, without warranty, the Property or that portion thereof then held under the Deed of Trust. The recitals of any matters or facts in any reconveyance executed under the Deed of Trust will be conclusive proof of the truthfulness thereof. To the extent permitted by law, the reconveyance may describe the grantee as "the person or persons legally entitled thereto." Neither Beneficiary nor Trustee will have any duty to determine the rights of persons claiming to be rightful grantees of any reconveyance. When the Property has been fully reconveyed, the last such reconveyance will operate as a reassignment of all future Rents of the Property to the person legally entitled thereto, unless such reconveyance expressly provides to the contrary.

#### Environmental Matters.

(a) *Definitions.* The following definitions apply to the provisions of the Deed of Trust concerning environmental matters:

(1) The term "Responsible Person" shall mean Trustor, and any other person who owns or acquires any interest in any part of the Property so long as Trustor continues to own the Property, including but not limited to any tenants, easement holders, licensees and other persons using or occupying the Property or any portion thereof and all persons in transit across any part of the Property.

(2) The term "Applicable Law" shall include, but shall not be limited to, each statute named or referred to in (2) below and any other local, state and federal laws, rules, regulations and ordinances, which govern, to the extent applicable to the Property: (i) the existence, cleanup or remedy of contamination on property; (ii) the protection of the environment from soil, air or water pollution, or from spilled, deposited or otherwise emplaced contamination; (iii) the emission or discharge of hazardous substances into the environment; (iv) the control of hazardous wastes; or (v) the use, generation, transport, treatment, removal or recovery of hazardous substances.

(3) The term "Hazardous Substance" shall mean (a) any oil, flammable substance, explosives, radioactive materials, hazardous wastes or substances, toxic wastes or substances or any other wastes, materials or pollutants which (i) pose a hazard to the Property or to persons on or about the Property or (ii) cause the Property to be in material violation of any Applicable Law; (b) asbestos in any form which is or could become friable, urea formaldehyde foam insulation, transformers or other equipment which contain dielectric fluid containing levels of polychlorinated biphenyls, or radon gas; (c) any chemical, material or substance defined as or included in the definition of "waste," "hazardous substances," "hazardous wastes," "hazardous materials," "extremely hazardous waste," "restricted hazardous waste," or "toxic substances" or words of similar import under any Applicable Law including, but not limited to, the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), 42 U.S.C. § 9601 et seq.; the Resource Conservation and Recovery Act ("RCRA"), 42 U.S.C. § 6901 et seq.; the Hazardous Materials Transportation Act, 49 U.S.C. § 1801 et seq.; the Federal Water Pollution Control Act, 33 U.S.C. § 1251 et seq.; the California Hazardous Waste Control Law ("HWCL"), CAL. HEALTH & SAFETY CODE § 25100 et seq.; the Hazardous Substance Account

Act (“HSAA”), CAL. HEALTH & SAFETY CODE § 25300 et seq.; the Underground Storage of Hazardous Substances Act, CAL. HEALTH & SAFETY CODE § 25280 et seq.; the Porter Cologne Water Quality Control Act (the “Porter Cologne Act”), CAL. WATER CODE § 13000 et seq.; the Safe Drinking Water and Toxic Enforcement Act of 1986 (Proposition 65); and Title 22 of the California Code of Regulations, Division 4, Chapter 30; (d) any other chemical, material or substance, exposure to which is prohibited, limited or regulated by any governmental authority or agency or may or could pose a hazard to the health and safety of the occupants of the Property or the owners or occupants of property adjacent to or surrounding the Property, or any other person coming upon the Property or adjacent property; and (e) any other chemical, materials or substance which may or could pose a hazard to the environment.

(b) *Covenants and Representations.*

(1) Except as set forth in the Official Statement related to the issuance of the Bonds, Trustor represents and warrants that there have not been during the period of Trustor’s ownership and, to the best of Trustor’s knowledge, information and belief, there have not been at any other times, any activities on the Property involving the use, generation, treatment, storage or disposal of any Hazardous Substances in material violation of Applicable Law (a) under, on or in the land included in the Property, (b) incorporated in the buildings, structures or improvements included in the Property, or (c) used in connection with any operations on or in the Property, in each case that would have a material adverse effect on the Trustor’s operations, taken as a whole.

(2) Trustor will not allow any Hazardous Substances to be brought onto, installed, used, stored, treated or disposed or transported over the Property in material violation of Applicable Law.

(3) Trustor represents that all activities and conditions on the Property are currently in compliance with Applicable Law, except to the extent that non-compliance could not reasonably be expected to materially impair the use of the Property or materially and adversely affect the value thereof. So long as Trustor owns the Property, Trustor covenants and agrees that all activities on the Property will at all times comply with Applicable Law except to the extent that non-compliance could not reasonably be expected to materially impair the use of the Property or materially and adversely affect the value thereof.

(4) Trustor will be solely responsible for and agrees to indemnify Beneficiary, the Authority and the Bond Trustee, protect and defend with counsel acceptable to Beneficiary, the Authority and the Bond Trustee, and hold Beneficiary, the Authority and the Bond Trustee harmless from and against any claims (including without limitation third party claims for personal injury or real or personal property damage), actions, administrative proceedings (including informal proceedings), judgments, damages, punitive damages, penalties, fines, costs, liabilities (including sums paid in settlements of claims), interest or losses, reasonable attorneys’ fees (including any fees and expenses incurred in enforcing this indemnity), reasonable consultant fees, and expert fees that arise from or in connection with the presence or release of any Hazardous Substance in, or from the Property, or any other violation of Applicable Law, or any breach of the foregoing representations and covenants.

**Default Provisions**

Definitions. As used in the Deed of Trust, the term “Event of Default” means each of the following:

(a) Trustor fails to perform or observe any term or condition of the Deed of Trust applicable to Trustor or to the Property, and such event or circumstance, if capable of being cured, is not cured within 60 days after written notice thereof is given by Trustee or Beneficiary to Trustor;

(b) The holder of any junior, subordinated or senior mortgage, deed of trust or other lien on the Property (without hereby implying Beneficiary's consent to any junior, subordinated or senior mortgage, deed of trust or other lien) is granted relief in any foreclosure for the enforcement of its remedies thereunder, which relief (i) negatively affects Beneficiary's rights hereunder and (ii) is not stayed; or

(c) If any Event of Default under the Indenture or under the Loan Agreement occurs.

**Rights and Remedies.** At any time after the occurrence and during the continuance of an Event of Default, Beneficiary and Trustee will each have the following rights and remedies:

(a) To declare all obligations secured hereby immediately due and payable;

(b) With or without notice, and without releasing Trustor from any obligation under the Deed of Trust, to cure any default of Trustor and, in connection therewith, to enter upon the Property and to perform such acts and things as Beneficiary or Trustee deem necessary or desirable to inspect, investigate, assess and protect the security thereof;

(c) To commence and maintain an action in any court of competent jurisdiction to foreclose the Deed of Trust instruments as a mortgage or to obtain specific enforcement of the covenants of Trustor thereunder, and Trustor agrees that such covenants are to be specifically enforceable by injunction or any other appropriate equitable remedy and that for the purposes of any suit related to such action, Trustor waives the defense of laches and any applicable statute of limitations;

(d) Beneficiary or its employees, acting by themselves or through a court-appointed receiver may enter upon, possess, manage, operate, dispose of and contract to dispose of the Property; negotiate with governmental authorities with respect to the Property's environmental compliance and remedial measures; make, terminate, enforce or modify leases of the Property upon such terms and conditions as Beneficiary deems proper; contract for goods and services, hire agents, employees and counsel, make repairs, alterations and improvements to the Property necessary to protect the security thereof; or incur the risks and obligations ordinarily incurred by owners of property;

(e) To execute a written notice of such Event of Default, and of its election to cause the Property to be sold to satisfy the obligations secured hereby, Trustee will give and record such notice as the law then requires as a condition precedent to a Trustee's sale. When the minimum period of time required by law after such notice has elapsed, Trustee will sell the Property at public auction to the highest bidder for cash payable at time of sale;

(f) To resort to and realize upon the security hereunder in such order and manner as Trustee and Beneficiary may, in their sole discretion, determine, and resort to any or all such security may be taken concurrently or successively and in one or several consolidated or independent judicial actions or lawfully taken non judicial proceedings, or both;

(g) To seek a judgment that Trustor has breached its covenants, representations or warranties with respect to the environmental matters set forth above, by commencing and maintaining an action in any court of competent jurisdiction for breach of contract pursuant to California Civil Procedure Code Section 736, and to seek the recovery of any and all costs, damages, expenses, fees, penalties, fines,

judgments, indemnification payments to third parties, and other reasonable out of pocket costs or expenses actually incurred by Beneficiary (collectively, the “Environmental Costs”) incurred by Beneficiary relating to the cleanup, remediation or other response action required by Applicable Law; and

(h) To waive its lien against the Property to the extent such property is found to be environmentally impaired in accordance with California Code of Civil Procedure Section 726.5 and to exercise any and all rights and remedies of an unsecured creditor against Trustor and all of Trustor’s assets and property for the recovery of any deficiency and Environmental Costs.

## **Security Agreement and Fixture Filing**

Grant of Security Interest. As additional security for the obligations secured by the Deed of Trust, Trustor grants to Beneficiary a security interest in and to the following items (collectively, the “Collateral”). Trustor is sometimes referred to herein as “Debtor” and Beneficiary is sometimes referred to herein as “Secured Party”.

(a) All goods, fixtures and other equipment of every kind in which Debtor owns or acquires any interest in connection with the Property, including, without limitation, all tools, equipment, appliances, heating, ventilating and air conditioning systems, plumbing, mechanical and electrical systems, elevators, lighting, alarm systems, fire control systems, carpets and carpeting, furnishings, furniture, trailers, mobile homes, service equipment, building or maintenance equipment, and all additions and accessions thereto, whether located at the Property, Debtor’s places of business or elsewhere;

(b) All inventory and tangible assets used or consumed in connection with the Property in which Debtor owns or acquires any interest, and all products thereof, whether in the possession of Debtor, warehousemen, bailees or any other person and to the extent located at the Property;

(c) All goods and property covered by any warehouse receipts, bills of lading and other documents evidencing any goods or other tangible personal property of any kind in which Debtor has any interest in connection with the Property or Collateral;

(d) All goods and other tangible personal property of every kind, character or nature in which Debtor has any interest, located on or used in the operation, use, maintenance, development or construction of or otherwise in connection with the Property or Collateral;

(e) All general intangibles, accounts, agreements, contracts, documents and leases in which Debtor has an interest related to the Property or the use, operation or maintenance of the Property;

(f) All profits, payments or proceeds of and from any and all agreements for the sale, lease, transfer or conveyance of the Property, subject to the rights of Debtor to collect and retain the same so long as no Event of Default will have occurred and is continuing; and

(g) Any and all products, accessions, additions, substitutions, replacements or proceeds of or to any of the Collateral, and any and all rent or income derived from the Collateral, subject to the rights of Debtor to collect and retain the same so long as no Event of Default will have occurred and is continuing.

Remedies. Upon an Event of Default, Beneficiary will be entitled to all the rights, powers and remedies granted a secured party under the California Uniform Commercial Code and other applicable law, including, but not limited to, the right to take possession of all such Collateral.

## **Amendments; Releases or Reconveyances**

The Deed of Trust may be amended, changed, modified or terminated at any time, without the necessity of obtaining the consent of the Authority, the Trustee or the holders of the Bonds, subject to the conditions and as provided in Section 8.04 of the Loan Agreement and Section 6.06 of the Indenture.

## **THE LEASE**

*Certain provisions of the Lease are summarized below. This summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of the Lease.*

### **Term**

The term of the Lease will commence on the date of the Lease (the “Commencement Date”) and will end on July 1, 2034 (the “Initial Term”) (or such other later date if Lessee exercises its extension option) (such date, as it may be extended, the “Expiration Date”). Based upon the occurrence of any of the events described in the Loan Agreement, the Lease may be terminated by Lessee by depositing with the Trustee sufficient cash or securities to defease the principal amount of the Bonds.

Extension Option. Lessee shall have two (2) options to extend the Term, each for five (5) years (such extension terms collectively, the “Extension Term” and, collectively with the Initial Term, the “Term”). The Extension Option must be exercised if at all by written notice (the “Option Notice”) delivered by Lessee to Lessor not less than four (4) months prior to the then-scheduled Expiration Date, provided, however, that the Extension Option shall not be exercisable unless, as of the date of the Option Notice and at the then scheduled Expiration Date, Lessee is not in default under the Lease. The Rent during the Extension Term to be set at an amount no less than the Fair Market Rent of the Premises (as defined in the Lease) at the date the option becomes exercisable. “Fair Market Rent” for purposes of the provisions of the Lease described in this section shall be determined pursuant to the Lease.

Base Rent. Lessor and Lessee acknowledge that Lessor is obtaining a loan (the “Loan”) from the California School Finance Authority (the “Lender”) as evidenced by a Loan Agreement dated as of June 1, 2014, by and between the Lender and Lessor (Lessor is sometimes referred to as the “Borrower”) (the “Loan Agreement”). The Loan will be funded by the proceeds of the Lender’s California School Finance Authority School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project), Series 2014A (the “2014A Bonds”) and its California School Finance Authority School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project) Series 2014B (Taxable) (the “2014B Bonds” and together with the 2014A Bonds, the “Bonds”) pursuant to an Indenture dated as of June 1, 2014 (the “Indenture”) by and between the Lender and The Bank of New York Mellon Trust Company, N. A., as trustee (the “Trustee”). So long as the Loan is outstanding, the “Base Rent” will be payable in accordance with the schedule set forth in Exhibit B of the Lease, subject to downward adjustment in the event of any defeasance of all or a portion of the Bonds or prepayment of all or a portion of the Loan.

Simultaneously with the execution and delivery of the Bonds, Lessee will deliver or cause to be delivered the Intercept Notice, substantially in the form set forth in the Lease (the “Intercept Notice”), to the State Controller. Amounts specified in the Intercept Notice for transfer to the Trustee shall be limited to State Apportionments. Lessee will amend, supplement or restate the Intercept Notice and deliver such to the State Controller from time to time as necessary or appropriate to indicate transfers to the Trustee to pay the amounts due under the Lease as they come due and to cure any delinquency in payment of such amounts. The Intercept Notice may provide additional amounts payable to the Trustee for purposes set forth in the Indenture; provided, that Lessee shall not grant preference or any prior right of funding access

or security in respect of the State Apportionment to any other payment indicated in the Intercept Notice or any other notice delivered pursuant to Section 17199.4 of the Education Code of the State of California.

### **Premises**

Lessor leases to Lessee, and Lessee leases from Lessor, the Premises, for the Term, at the Rent (as defined below) and upon and subject to all of the terms, covenants and conditions set forth in this Lease.

### **Rent and Expenses**

Rent Defined. Subject to the terms of the Lease Agreement, Base Rent, Expenses, Additional Rent and all other monetary obligations of Lessee to Lessor or to third parties arising under the terms of the Lease are deemed to be rent ("Rent").

Expenses. Lessee shall be responsible for all Expenses which Lessee shall pay to Lessor within thirty (30) days after receiving a statement from Lessor itemizing (with reasonable description) all charges included thereon.

"Expenses" shall mean all costs and expenses of the ownership, operation, maintenance, repair or replacement, and insurance of the Premises, as determined by standard accounting practices, including, by way of illustration only, and not by way of limitation, to the extent they apply to the Premises:

- (i) Gross receipts taxes, whether assessed against Lessor or assessed against Lessee and collected by Lessor;
- (ii) Water, sewage, and waste or refuse removal charges;
- (iii) Gas, electricity, telephone and other utilities;
- (iv) Reasonable costs incurred in the day-to-day management (if any), including the cost of management personnel;
- (v) Air conditioning and heating;
- (vi) Elevator maintenance (if any);
- (vii) Supplies, materials, labor, equipment, and utilities used in or related to the operation and maintenance of the Premises;
- (viii) All maintenance, replacement and repair costs including, without limitation, janitorial, cleaning and repair services relating to the Premises and all improvements thereon, including, without limitation, air conditioning systems, landscaping, service areas, building exteriors (including painting), signs and directories, repairing and replacing roofs, walls, janitorial (if any is supplied), capital improvements and upgrades, and cost of compliance with applicable laws;
- (ix) Capital improvements made to the Premises (whether funded in full or amortized with reasonable financing charges) which may be required by any government authority or which will improve the operating efficiency of the Premises;

(x) Real Property Taxes and personal property taxes, if any; and

(xii) Any other costs or expenses incurred by Lessor under the Lease and not otherwise reimbursed by Lessee or any other lessee of the Premises. Expenses will not include depreciation on the buildings of which the Premises are a part.

Additional Rent. In addition to Base Rent and Expenses, Lessee will be responsible for the payment of Additional Rent. Additional Rent will be paid to Lessor on demand or, if such Additional Rent is ongoing and can be calculated on a periodic basis, on a monthly basis pursuant to a written schedule from time to time delivered by Lessor.

“Additional Rent” will include but not be limited to the following:

(i) All amounts required to reimburse Lessor, or satisfy Lessor’s obligations, for any fees, expenses, taxes, indemnities, assessments or other payments that it pays under the terms of the Loan Agreement to or on behalf of the Lender;

(ii) Amounts necessary to reimburse Lessor, or satisfy Lessor’s obligations, for any payments it makes as may be required under the Loan Agreement or the Lease; and

(v) Amounts necessary to reimburse Lessor for payments it makes with respect to Lessor’s reasonable general operating expenses, including Lessor’s payment of Lessor’s share of the reasonable general operating expenses of Lessor’s sole member.

Payment. Lessee’s obligation to pay Rent will commence on the Rent Commencement Date. Lessee will cause all Rent payable to Lessor under the Lease to be received by Lessor in lawful money of the United States on or before the day on which it is due, without offset or deduction. Rent for any period during the Term hereof which is for less than one full calendar month shall be prorated based upon the actual number of days of said month. Payment of Rent due to Lessor will be made to Lessor at its address stated herein or to such other persons or place as Lessor may from time to time designate in writing. Subject to the terms of the Indenture, and so long as any of the Bonds or the Loan remains outstanding, Lessee will: (a) through the Intercept Notice, cause the Los Angeles County Office of Education to transfer the portion of the State Apportionment attributable to the School to the Trustee for deposit in the Revenue Fund; and (b) cause the Trustee to pay from the Revenue Fund the Rent due to Lessor under the terms of the Lease.

Budgeting Rent. Lessee covenants to take such action as may be necessary to include all such payments of Rent due under the Lease in its annual budgets, to make, as necessary, annual appropriations for all such payments and to take such action annually as shall be required to provide funds in such year for such payments of Rent.

Source of Rent Payments. The School’s obligation to pay the Rent is a general obligation of the School, and the School pledges the Gross Revenues of the School to for the payment of the Rent, but Lessor agrees that under no circumstances shall Lessee be required to advance any moneys derived from, nor shall Lessor have recourse to, any revenues or assets of Lessee, including but not limited to revenues or assets attributable to, or designated by any third party for, any other school operated by Lessee or pledged by Lessee to secure loans to or financings or leases for such other school. Nothing contained in this paragraph shall be construed to release Lessor from the performance of any of the agreements on its part contained, and in the event Lessor shall fail to perform any such agreements on its part, Lessee may institute such action against Lessor as Lessee may deem necessary to compel performance so long as such action does not abrogate the obligations of Lessee contained in the first sentence of this paragraph.



Lessee may, however, at Lessee's own cost and expense and in Lessee's own name or in the name of Lessor prosecute or defend any action or proceeding or take any other action involving third persons which Lessee deems reasonably necessary in order to secure or protect Lessee's right of possession, occupancy and use under the Lease Agreement, and in such event Lessor hereby agrees to cooperate fully with Lessee and to take such action necessary to effect the substitution of Lessee for Lessor in such action or proceeding if Lessee shall so request.

As used in the Lease Agreement, "Gross Revenues of the School" means all income and revenues directly or indirectly derived by Lessee's operation of the School, including without limitation, per-pupil revenues and other funding received from the State of California or by virtue of the Charter granted to Lessee for the School and all gifts, grants, bequests and contributions (including income and profits therefrom) specifically restricted by the donor or maker thereof to the School or the Premises, to the extent not specifically restricted by the donor or maker thereof to a particular purpose inconsistent with their use for the payments required under the Lease.

## **Use**

Use. Lessee shall use and occupy the Premises only for "educational facilities" as defined in Section 17173(f) of the Education Code of the State of California in order to operate a charter school that is exempt from federal income taxation under Section 501(a) of the Internal Revenue Code (the "Code") as an organization described in Code Section 501(c)(3) and that qualifies as an "educational organization" as described under Code Section 170(b)(1)(A)(ii) (the "Agreed Use"), and for no other purpose, provided that Lessee will not rent the Premises as residential rental property to others, or permit any subtenant to rent the Premises as residential rental property to others. Lessee will not use or permit the use of the Premises in a manner that is unlawful, creates damage, waste or a nuisance, or that disturbs other tenants on the Premises or causes damage to neighboring premises or properties. Subject to the foregoing, Lessee may, without Lessor's prior written consent, operate the School with such grade levels as Lessee may from time to time determine in its reasonable judgment and, if so requested by Lessee, Lessor will cooperate with Lessee, and execute any applications or other documentation reasonably required, for the purpose of obtaining a change in any zoning or other use restriction, including any conditional use permit currently or thereafter applicable to the Premises, to permit Lessee to use or operate the Premises for additional or different grades, provided, that Lessee shall reimburse Lessor for any reasonable expenses incurred in connection therewith.

### Hazardous Substances.

(a) *Reportable Uses Require Consent.* Lessee will not engage in any activity in or on the Premises which constitutes a Reportable Use of Hazardous Substances (both as defined in the Lease) without the express prior written consent of Lessor and timely compliance (at Lessee's expense) with all Applicable Requirements.

(b) *Duty to Inform Lessor.* If Lessee knows, or has reasonable cause to believe, that a Hazardous Substance has come to be located in, on, under or about the Premises, other than as previously consented to by Lessor, Lessee will immediately give written notice of such fact to Lessor, and provide Lessor with a copy of any report, notice, claim or other documentation which it has concerning the presence of such Hazardous Substance.

(c) *Lessee Remediation.* Lessee will not cause or permit any Hazardous Substance to be spilled or released in, on, under, or about the Premises (including through the plumbing or sanitary sewer system) and will promptly, at Lessee's expense, comply with all Applicable Requirements and take all investigatory and/or remedial action reasonably recommended, whether or not formally ordered or

required, for the cleanup of any contamination of, and for the maintenance, security and/or monitoring of the Premises or neighboring properties, that was caused or materially contributed to by Lessee, or pertaining to or involving any Hazardous Substance brought onto the Premises during the Term of the Lease, by or for Lessee, or any third party.

(d) *Lessee Indemnification.* Lessee will indemnify, defend and hold Lessor, its managing member, and the agents, employees, officers, directors of either of them harmless from and against any and all loss of rents and/or damages, liabilities, judgments, claims, expenses, penalties, and attorneys' and consultants' fees arising out of or involving any Hazardous Substance brought onto the Premises by or for Lessee (provided, however, that Lessee shall have no liability under the Lease with respect to underground migration of any Hazardous Substance under the Premises from adjacent properties not caused or contributed to by Lessee).

(e) *Lessor Indemnification.* Lessor shall indemnify, defend and hold Lessee, and its agents, employees, officers, and directors, harmless from and against any and all loss of rents and/or damages, liabilities, judgments, claims, expenses, penalties, and attorneys' and consultants' fees arising out of or involving any Hazardous Substance brought onto the Premises (by a party other than Lessee) prior to the Commencement Date (provided, however, that Lessor shall have no liability under the Lease with respect to underground migration of any Hazardous Substance under the Premises from adjacent properties not caused or contributed to by Lessor).

(f) *Hazardous Substance Condition Remediation.* If Lessee becomes aware of a Hazardous Substance Condition (as defined in the Lease) occurring during the Term of the Lease, then Lessee shall notify Lessor and Lessor shall make the investigation and remediation thereof required by the Applicable Requirements, the costs relating thereto constituting an Expense for which Lessee is responsible and the Lease shall continue in full force and effect, but subject to Lessor's rights under the Lease; provided, however, that if a Hazardous Substance Condition occurs as a result of Hazardous Materials that are brought on the Premises (by a party other than Lessee) prior to the Commencement Date, then Lessor shall be solely responsible for making the investigation and remediation thereof at its sole cost and expense, and the Lease shall continue in full force and effect.

## **Maintenance; Repairs**

Lessee's Obligations. Subject to the provisions of the Lease under the headings "Lessor's Obligations", "Damage or Destruction" and "Condemnation", Lessee will, at Lessee's sole expense, keep the interior, exterior and structural elements of the Premises in good order, condition and repair; and keep the exterior, structural and major utility components of the Premises and other portions of the Premises in good order, condition and repair, including, but not limited to, all equipment or facilities, such as plumbing, HVAC equipment, electrical, lighting facilities, boilers, pressure vessels, fire protection system, fixtures, walls (interior and exterior), ceilings, floors, windows, doors, plate glass, skylights, landscaping, driveways, parking lots, fences, retaining walls, signs, sidewalks and parkways located in, on, or adjacent to the Premises. Lessee's obligations shall include restorations, replacements or renewals when necessary to keep the Premises and all improvements thereon or a part thereof in good order, condition and state of repair. Subject to the provisions of the Lease under the headings "Damage or Destruction" and "Condemnation" and to the provisions of the Indenture (governing funds relating to, among other things, insurance and condemnation proceeds and charter revocation), it is intended by the Parties to the Lease that Lessor have no obligation, in any manner whatsoever, to repair and maintain the Premises, or the equipment therein, all of which obligations are intended to be that of Lessee. It is the intention of the Parties that the terms of the Lease govern the respective obligations of the Parties as to maintenance and repair of the Premises, and they expressly waive the benefit of any statute now or hereafter in effect to the extent it is inconsistent with the term so of the Lease.

Lessor's Obligations. Subject to the provisions of the Lease under the headings "Condition", "Compliance", "Damage or Destruction" and "Condemnation", Lessor will keep the Common Facilities and Areas and other portions of the Premises not covered in the Lease in good order, condition and repair. All costs and expenses incurred by Lessor in connection with the aforesaid maintenance and repair shall be deemed "Expenses" under the Lease. Lessor's obligations will include restorations, replacements or renewals when necessary to keep the Premises and all improvements thereon or a part thereof in good order, condition and state of repair, and the costs relating thereto shall be deemed an "Expense" under the Lease.

## **Insurance; Indemnity**

Liability. Lessee will keep in force such liability insurance policies and in such amounts as set forth in the Lease. The premium for such insurance shall be deemed an "Expense" under the Lease.

Property. Lessee will obtain and keep in force a policy or policies of property insurance in the name, and for the benefit, of Lessor, with loss payable to Lessor and to any lender insuring loss or damage to the Premises. The amount of such insurance shall be as set forth in the Lease. The premium for such insurance shall be deemed an "Expense" under the Lease.

Waiver of Subrogation. Without affecting any other rights or remedies, Lessee and Lessor each release and relieve the other, and waive their entire right to recover damages against the other, for loss of or damage to its property arising out of or incident to the perils required to be insured against in the Lease. The effect of such releases and waivers is not limited by the amount of insurance carried or required, or by any deductibles applicable to the Lease. The Parties agree to have their respective property damage insurance carriers waive any right to subrogation that such companies may have against Lessor or Lessee, as the case may be, so long as the insurance is not invalidated thereby.

Indemnity. Except for Lessor's negligence or willful misconduct, Lessee will indemnify, protect, defend and hold harmless the Premises, Lessor and its agents, partners, members, directors, and officers, from and against any and all claims, loss of rents and/or damages, liens, judgments, penalties, attorneys' and consultants' fees, expenses and/or liabilities arising out of, involving, or in connection with, the use and/or occupancy of the Premises by Lessee. If any action or proceeding is brought against Lessor by reason of any of the foregoing matters, Lessee shall upon notice defend the same at Lessee's expense by counsel reasonably satisfactory to Lessor and Lessor shall cooperate with Lessee in such defense. Lessor need not have first paid any such claim in order to be defended or indemnified. The provisions of the Lease described in this section shall survive the termination of the Lease.

Exemption of Lessor from Liability. Lessor will not be liable for injury or damage to the person or goods, wares, merchandise or other property of Lessee, Lessee's employees, contractors, invitees, customers, or any other person in or about the Premises, whether such damage or injury is caused by or results from fire, steam, electricity, gas, water or rain, or from the breakage, leakage, obstruction or other defects of pipes, fire sprinklers, wires, appliances, plumbing, HVAC or lighting fixtures, or from any other cause, whether the said injury or damage results from conditions arising upon the Premises or from other sources or places.

## **Real Property Taxes**

Payment of Taxes. Lessee will timely file for exemption against any Real Property Taxes and will maintain such exemption during the Term. In any event, Lessee shall pay, before the same become past due, the Real Property Taxes applicable to the Property during the Term to the extent any such Real Property Taxes are charged, levied, assessed or imposed.

Personal Property Taxes. Lessee will timely file for exemption against any taxes on Lessee Owned Alterations, Utility Installations, Trade Fixtures, furnishings, equipment and all personal property of Lessee and will maintain such exemption during the Term. In any event, Lessee will pay, prior to delinquency, all such taxes to the extent they are charged, levied, assessed or imposed after an exemption for such taxes is filed.

### **Assignment and Subletting**

By Lessee. Lessee may not sublease, assign, mortgage, pledge, hypothecate or encumber the Lease or any of Lessee's interest under the Lease without the prior written consent of Lessor (which may not be unreasonably withheld). Lessee acknowledges that, pursuant to the Loan Agreement, Lessor is required to obtain Lender's approval to a sublease, assignment or other transfer of Lessee's interest in the Lease and that Lessor's disapproval will be deemed reasonable if based on Lender's disapproval. Lessee acknowledges that the financing of the Premises through the tax-exempt Bonds may restrict the assignees which could be approved by Lessor.

By Lessor. Lessee acknowledges that the Premises are subject to a deed of trust and assignment of rents in favor of the Lender and that the Lease is assigned to the Lender as security for the Loan.

### **Default; Breach; Remedies**

Default; Breach. A "Default" is defined as a failure by Lessee to comply with or perform any of the terms, covenants or conditions under the Lease. A "Breach" is defined as the occurrence of one or more of the following Defaults, and the failure of Lessee to cure such Default within any applicable grace period:

- (a) The abandonment of the Premises.
- (b) The failure of Lessee to make any payment of Rent required to be made by Lessee under the Lease, whether to Lessor or to a third party, when due, to provide reasonable evidence of insurance or surety bond, or to fulfill any obligation under the Lease which endangers or threatens life or property, where such failure continues for a period of 3 business days following written notice to Lessee.
- (c) Any material representation or warranty made in the Lease, or in any report, certificate, financial statement, or instrument furnished in connection with the Lease, proves to have been false or misleading when made, in any material respect.
- (d) Lessee violates or fails to observe or perform certain covenants contained in the Lease.
- (e) The Debt Service Coverage Ratio (as defined in the Lease) for any Fiscal Year ending on or after June 30, 2015 is less than 1.00:1.00 for such Fiscal Year.
- (f) A Default by Lessee as to the terms, covenants, conditions or provisions of the Lease, other than those described in subparagraphs (a) through (d) above, where such Default continues for a period of thirty (30) days after written notice; provided, however, that if the nature of Lessee's Default is such that more than 30 days are reasonably required for its cure, then it will not be deemed to be a Breach if Lessee commences such cure within said thirty (30) day period and thereafter diligently prosecutes such cure to completion.
- (g) The occurrence of any of the following events: (i) the making of any general arrangement or assignment for the benefit of creditors; (ii) becoming a "debtor" as defined in 11 U.S.C. §

101 or any successor statute thereto (unless, in the case of a petition filed against Lessee, the same is dismissed within 90 days); (iii) the appointment of a trustee or receiver to take possession of substantially all of Lessee's assets located at the Premises or of Lessee's interest in the Lease, where possession is not restored to Lessee within sixty (60) days; or (iv) the attachment, execution or other judicial seizure of substantially all of Lessee's assets located at the Premises or of Lessee's interest in the Lease, where such seizure is not discharged within sixty (60) days; provided, however, in the event that any provision of this subparagraph (e) is contrary to any applicable law, such provision shall be of no force or effect, and not affect the validity of the remaining provisions.

- (h) The discovery that any financial statement of Lessee given to Lessor was materially false.

## **Remedies**

If Lessee fails to perform any of its affirmative duties or obligations (other than compliance with covenants and financial reporting requirements pursuant to the provisions of the Lease), within fifteen (15) days after written notice (or, in the case of those duties and obligations that cannot reasonably be performed within fifteen (15) days after notice, to commence and diligently prosecute such duties and obligations to completion), Lessor may, at its option, perform such duty or obligation on Lessee's behalf, including but not limited to the obtaining of reasonably required bonds, insurance policies, or governmental licenses, permits or approvals. Lessee shall pay to Lessor the costs and expenses incurred by Lessor in such performance upon receipt of an invoice therefor. In the event of a Breach, including Lessee's failure to comply with the covenants or financial reporting requirements set forth in the Lease, Lessor may, with or without further notice or demand, and without limiting Lessor in the exercise of any right or remedy which Lessor may have by reason of such Breach:

- (a) Terminate Lessee's right to possession of the Premises by any lawful means, in which case the Lease shall terminate and Lessee shall immediately surrender possession to Lessor. In such event Lessor shall be entitled to recover from Lessee: (i) the unpaid Rent which had been earned at the time of termination; (ii) the worth at the time of award of the amount by which the unpaid Rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that Lessee proves could have been reasonably avoided; (iii) the worth at the time of award of the amount by which the unpaid Rent for the balance of the term after the time of award exceeds the amount of such rental loss that Lessee proves could be reasonably avoided; and (iv) any other amount necessary to compensate Lessor for all the detriment proximately caused by Lessee's failure to perform its obligations under the Lease or which in the ordinary course of things would be likely to result therefrom, including but not limited to the cost of recovering possession of the Premises, expenses of reletting, including necessary renovation and alteration of the Premises, reasonable attorneys' fees of Lessor, and that portion of any leasing commission paid by Lessor in connection with the Lease applicable to the unexpired term of the Lease. The worth at the time of award of the amount referred to in provision (iii) of the immediately preceding sentence shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of the District within which the Premises are located at the time of award plus one percent. Efforts by Lessor to mitigate damages caused by Lessee's Breach of the Lease will not waive Lessor's right to recover damages under the Lease. If termination of the Lease is obtained through the provisional remedy of unlawful detainer, Lessor shall have the right to recover in such proceeding any unpaid Rent and damages as are recoverable therein, or Lessor may reserve the right to recover all or any part thereof in a separate suit. If a notice and grace period required under the Lease was not previously given, a notice to pay rent or quit, or to perform or quit given to Lessee under the unlawful detainer statute shall also constitute the notice required by the Lease. In such case, the applicable grace period required by the Lease and the unlawful detainer statute shall run concurrently, and the failure of Lessee to cure the Default within the greater of the two such grace periods shall constitute both an unlawful detainer and a Breach of the Lease entitling Lessor to the remedies provided for in the Lease and/or by said statute.

(b) Continue the Lease and Lessee's right to possession and recover the Rent as it becomes due.

(c) Pursue any other remedy now or hereafter available under the laws or judicial decisions of the state wherein the Premises are located.

Interest. Any monetary payment due Lessor under the Lease not received by Lessor when due as to scheduled payments (such as Base Rent) or within thirty (30) days following the date on which it was due for non-scheduled payments, shall bear interest from the date when due as to scheduled payments, or the 31st day after it was due as to non-scheduled payments. The interest ("Interest") charged shall be computed at the rate of 10% per annum but may not exceed the maximum rate allowed by law. Interest is payable in addition to any late charges and default rate interest under the Loan Agreement.

## APPENDIX D

### FORM OF CONTINUING DISCLOSURE AGREEMENT

**CALIFORNIA SCHOOL FINANCE AUTHORITY  
SCHOOL FACILITY REVENUE BONDS  
(MAGNOLIA SCIENCE ACADEMY-1, RESEDA PROJECT)  
SERIES 2014A & SERIES 2014B (TAXABLE)**

THIS CONTINUING DISCLOSURE AGREEMENT dated as of June 1, 2014 (the “Disclosure Agreement”) is executed and delivered by MPM Sherman Way LLC, a California limited liability company (the “Borrower”), the Trustee under the Indenture, The Bank of New York Mellon Trust Company, N.A., in its capacity as Dissemination Agent hereunder (the “Dissemination Agent”) and Magnolia Educational & Research Foundation, organized as a California nonprofit public benefit corporation and doing business as Magnolia Public Schools (the “Lessee”), which operates Magnolia Science Academy 1, also known as Magnolia Science Academy (the “School”), for the holders of the above-captioned bonds (the “Bonds”) under the Indenture of Trust, dated as of June 1, 2014 (the “Indenture”), between the California School Finance Authority (the “Issuer”) and the Trustee. The Borrower, the Lessee and the Dissemination Agent covenant and agree as follows:

**Section 1. Purpose of the Disclosure Agreement.** This Disclosure Agreement is being executed and delivered by the Borrower, the Lessee and the Dissemination Agent for the benefit of the Holders and Beneficial Holders of the Bonds and in order to assist the Participating Underwriter in complying with, and constitutes the written undertaking of the Borrower and the Lessee for the benefit of the Bondholders required by, Section (b)(5)(i) of Securities and Exchange Commission Rule 15c2-12 under the Securities Exchange Act of 1934, as amended (17 C.F.R. § 240.15c2-12) (the “Rule”).

Each of the Borrower and the Lessee, as an “obligated person” within the meaning of the Rule, undertakes to provide the following information as provided in this Disclosure Agreement:

- (a) Annual Financial Information;
- (b) Quarterly Information; and
- (c) Operating Data.

**Section 2. Definitions.** In addition to the definitions set forth in the Indenture, which apply to any capitalized term used in this Disclosure Agreement unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

“Annual Financial Operating Data Information” means the financial information or Operating Data with respect to the School, provided at least annually, of the type included in Appendices A and B to the Limited Offering Memorandum, which Annual Financial Information shall include Audited Financial Statements, if available.

“Audited Financial Statements” means the annual audited financial statements of the School, which may be included in MERF’s audit.

“Beneficial Holders” means any person who has the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, any Bonds, including persons holding Bonds through nominees or depositories.

“CUSIP Number” means, with respect to the Bonds, 13059TAT6, 13059TAU3, 13059TAV1 and 13059TAW9.

“Dissemination Agent” means the Dissemination Agent named above, acting in its capacity as Dissemination Agent hereunder, or any successor Dissemination Agent designated in writing by the Borrower and which has filed with the Trustee a written acceptance of such designation.

“Holders” means either the registered owners of the Bonds, or, if the Bonds are registered in the name of The Depository Trust Company or another recognized depository, any applicable participant in its depository system.

“Lease” means the Lease Agreement, dated as of June 1, 2014, between the Borrower and the Lessee to lease the Facility financed with the proceeds of the Bonds.

Listed Events means any of the events listed in Section 4(a) hereof.

“Limited Offering Memorandum” means the Limited Offering Memorandum dated June 18, 2014 with respect to the Bonds.

“Operating Data” means, to the extent not included in Annual Financial Information, the following information with respect to the Borrower, substantially in the form set forth in the Limited Offering Memorandum, including Appendix A thereto:

- (i) the information regarding completion of rehabilitation of the Facility (until completion);
- (ii) status of the MERF’s obligations under the Lease (e.g., whether any are delinquent and to what extent);
- (iii) a copy (which may be sent electronically) of the School’s adopted annual budget for the present Fiscal Year and a copy of revisions, if any, to the School’s annual budget as approved by its governing board;
- (iv) if the School has determined to renovate or expand its facilities, a capital assessment plan (which may be sent electronically) detailing the condition of each of the facilities and the projected sources of funding such needs, if any; and
- (v) a copy of the official School Fall Enrollment Report (which may be sent electronically) showing the School’s official November 1 enrollment.

“Participating Underwriter” means the original underwriter of the Bonds required to comply with the Rule in connection with offering of the Bonds.

“Quarterly Financial and Operating Data Information” means (a) unaudited quarterly financial statements of MERF with respect to the School for each fiscal quarter (including year to date), prepared in accordance with generally accepted accounting principles or with notes discussing any variance therefrom; (b) a comparison of actual results versus budgeted results for the period; (c) enrollment statistics for each grade in the School as of the end of each fiscal quarter; and (d) the waiting list, if any, by grade level.

“Repository” means the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access (“EMMA”) system currently at <http://emma.msrb.org>.



### **Section 3. Provision of Reports.**

(a) While any Bonds are outstanding, the Borrower shall, or upon written direction shall cause the Dissemination Agent to, provide (i) the Annual Financial Information on or before December 20 of each year (the “Annual Report Date”), beginning on or before December 20, 2014 to the Repository in an electronic format as prescribed by the Repository; and (ii) the Quarterly Information, on or before the date which is 60 days after the end of each calendar quarter, beginning 60 days after the calendar quarter ending December 31, 2014 (each a “Quarterly Report Date”). If the Dissemination Agent is to provide the Annual Financial Information or the Quarterly Information, not later than 10 Business days prior to said date, the Borrower shall provide the Annual Financial Information or Quarterly Information, as applicable, to the Dissemination Agent. To the extent not included in the audited final statements of MERF with respect to the School, the Annual Report shall also include a certificate substantially in the form attached hereto as EXHIBIT B that provides certain School data and demonstrates MERF’s compliance with certain operating covenants contained in the Lease.

The School and MERF shall include with each such submission of Annual Financial Information or Quarterly Information to the Dissemination Agent a written representation addressed to the Dissemination Agent, upon which the Dissemination Agent may conclusively rely, to the effect that the Annual Financial Information or Quarterly Information is the Annual Financial Information or Quarterly Information, as applicable, required to be provided by it pursuant to this Disclosure Agreement and that it complies with the applicable requirements of this Disclosure Agreement. In each case, the Annual Financial Information or Quarterly Information may be submitted as a single document or as a set of documents, and all or any part of such Annual Financial Information or Quarterly Information may be provided by specific cross reference to other documents previously provided to the Repository or filed with the Securities and Exchange Commission and, if such a document is a final Limited Offering Memorandum within the meaning of the Rule, available from the Municipal Securities Rulemaking Board, as provided in the definition of Annual Financial Information. Such information shall include the CUSIP Number for the Bonds or such other identifying information as may be prescribed by the Municipal Securities Rulemaking Board or any successor thereto.

(b) If not provided as part of the Annual Financial Information, the Borrower shall, or, upon furnishing such Audited Financial Statements to the Dissemination Agent shall cause the Dissemination Agent to, provide Audited Financial Statements when and if available while any Bonds are Outstanding to the Repository.

(c) If by 5 days prior to an Annual Report Date or a Quarterly Report Date the Dissemination Agent has not received a copy of the required information, the Dissemination Agent shall contact the Borrower to give notice that the Dissemination Agent has not received the Annual Financial Information and that such information must be provided to the Repository, by the applicable Annual Report Date or Quarterly Report Date.

(d) The Dissemination Agent shall:

(i) Determine each year the appropriate format for filing the Annual Report with the Repository and the proper form for such filing; and

(ii) to the extent the Borrower has provided the Annual Financial Information to the Dissemination Agent and required such information be sent to the Repository, file a report with the Borrower certifying that the Annual Financial Information has been provided by the Dissemination Agent to the Repository, pursuant to this Disclosure Agreement, stating the date it was provided.

(e) If the Dissemination Agent does not receive the Annual Financial Information from the Borrower required by clause (a) of this Section by the applicable Annual Report Date, the Dissemination Agent shall, without further direction or instruction from the Borrower, provide to the Municipal Securities Rulemaking Board notice of any such failure to provide to the Dissemination Agent Annual Financial Information by the applicable Annual Report Date. For the purposes of determining whether information received from the Borrower is Annual Financial Information, the Dissemination Agent shall be entitled conclusively to rely on the written representation made by the Borrower pursuant to this Section.

(f) In addition to the foregoing, the Borrower shall hold an annual investor call for the purpose of reviewing the previous year's financial results. Such investor call shall be preceded by notice provided in the manner prescribed in Section 3(a), above, and shall be held within 45 days after approval by the Borrower of the Annual Financial Information or the audited annual financial statements, whichever is later if separately approved. If the Borrower does not conduct the investor call contemplated herein, it shall not constitute a failure hereunder, shall not give rise to a requirement to provide notice to the MSRB or otherwise, and shall not provide the basis for any remedy or enforcement action hereunder.

#### **Section 4. Reporting of Significant Events**

(a) This Section 4 shall govern the giving of notices of the occurrence of any of the following events with respect to the Bonds:

- (1) Principal and interest payment delinquencies;
- (2) Non-payment related defaults, if material;
- (3) Unscheduled draws on debt service reserves reflecting financial difficulties;
- (4) Unscheduled draws on credit enhancements reflecting financial difficulties;
- (5) Substitution of credit or liquidity providers, or their failure to perform;
- (6) Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the Bonds, or other material events affecting the tax status of the Bonds;
- (7) Modifications to rights of Bondholders, if material;
- (8) Bond calls, if material, and tender offers;
- (9) Defeasances;
- (10) Release, substitution, or sale of property securing repayment of the Bonds, if material;
- (11) Rating changes;
- (12) Bankruptcy, insolvency, receivership, or similar event of the Borrower;
- (13) The consummation of a merger, consolidation, or acquisition involving the Borrower or the sale of all or substantially all of the assets of the Borrower, other than in the

ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to such actions, other than pursuant to its terms, if material; and

(14) Appointment of a successor or additional trustee or the change of name of a trustee, if material.

(b) For purposes of the event identified in subsection (a)(12), the event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent, or similar officer for a Borrower in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the Borrower, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement, or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of such Borrower.

(c) The Trustee shall, within three (3) Business Days of obtaining actual knowledge of the occurrence of any of the Listed Events (except events listed in clauses (a)(1), (8), or (9)), contact the Borrower and the Dissemination Agent, inform each person of the event, and request that the Borrower promptly notify the Dissemination Agent and the Trustee in writing whether or not to report the event pursuant to subsection (f). For the purpose of this Disclosure Agreement “actual knowledge” means actual knowledge at the corporate trust office of the Trustee by an officer of the Trustee with responsibility for matters related to the administration of the Indenture.

(d) If the Borrower obtains knowledge of the occurrence of a Listed Event, because of a notice from the Trustee pursuant to subsection (b) or otherwise, the Borrower shall, within three (3) Business Days of receiving such notice from the Trustee, notify the Trustee and the Dissemination Agent in writing. Such notice shall instruct the Dissemination Agent to report the occurrence pursuant to subsection (f) (the Trustee and the Dissemination Agent have no obligation to determine the materiality thereof or whether an unscheduled draw reflects financial difficulties).

(e) If in response to a request under subsection (c), the Borrower determines that the Listed Event (except events listed in subsections (a)(1), (3), (4), (5), (8) (other than bond calls), (9), (11), (12), or (14)) is not material, the Borrower shall, within three (3) Business Days of receiving such request from the Trustee, so notify the Dissemination Agent and the Trustee in writing and instruct the Dissemination Agent not to report the occurrence pursuant to subsection (f).

(f) If the Dissemination Agent has been instructed by the Borrower to report the occurrence of a Listed Event, the Dissemination Agent shall file in a timely manner, not in excess of ten Business Days after such occurrence (assuming it has received instructions not less than two Business Days prior to the expiration of such ten Business Day period), a notice of such occurrence with the MSRB in an electronic format as prescribed by the MSRB (which, as of the date hereof, is EMMA). Notwithstanding the foregoing, notice of Listed Events described in subsections (a)(8) (other than tender offers) and (9) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to the owners of affected Bonds pursuant to the Indenture.

**Section 5. Termination of Reporting Obligation.** The Borrower’s, the Lessee’s, the Dissemination Agent’s and the Trustee’s obligations under this Disclosure Agreement shall automatically terminate once the Bonds are no longer outstanding or, with respect to the Trustee or the Dissemination

Agent, as appropriate, upon the resignation or removal of the Trustee or the Dissemination Agent or with respect to the Borrower and the Lessee, once they are no longer obligated on the Bonds.

**Section 6. Dissemination Agent.** The Borrower may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Agreement, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent upon notice to the Dissemination Agent. The Dissemination Agent may resign at any time by providing 30 days' written notice to the Borrower and the Trustee. The initial Dissemination Agent shall be the Dissemination Agent named herein. It is understood and agreed that any information that the Dissemination Agent may be instructed to file with the Repository shall be prepared and provided to it by the Borrower. The Dissemination Agent has undertaken no responsibility with respect to any reports, notices or disclosures provided to it under this Disclosure Agreement, and has no liability to any person, including any holder of Bonds, with respect to any such reports, notices or disclosures. The fact that the Dissemination Agent or any affiliate thereof may have a fiduciary or banking relationship with the Borrower shall not be construed to mean that the Dissemination Agent has actual knowledge of any event or condition, except as may be provided by written notice from the Borrower.

**Section 7. Amendment; Waiver.** Notwithstanding any other provision of this Disclosure Agreement, the Borrower, the Lessee, the Dissemination Agent and the Trustee may amend this Disclosure Agreement and any provision of this Disclosure Agreement may be waived by the parties hereto, if such amendment or waiver is supported by an opinion of counsel expert in federal securities laws, acceptable to the Borrower and the Trustee, to the effect that such amendment or waiver would not, in and of itself, cause the undertakings herein to violate the Rule, provided that neither the Trustee nor the Dissemination Agent shall be obligated to agree to any amendment that modifies the duties or liabilities of the Dissemination Agent or the Trustee without their respective consent thereto.

**Section 8. Additional Information.** Nothing in this Disclosure Agreement shall be deemed to prevent the Borrower or the Lessee from disseminating any other information, using the means of dissemination set forth in this Disclosure Agreement or any other means of communication, or including any other information in any Annual Financial Information or Quarterly Information or notice of occurrence of a material event, in addition to that which is required by this Disclosure Agreement. If the Borrower or the Lessee chooses to include any information in any Annual Financial Information or Quarterly Information or notice of occurrence of a material event in addition to that which is specifically required by this Disclosure Agreement, the Borrower or the Lessee, as the case may be, shall have no obligation under this Disclosure Agreement to update such information or include it in any future Annual Financial Information or Quarterly Information.

**Section 9. Default.** In the event of a failure of the Borrower, the Lessee, the Dissemination Agent or the Trustee to comply with any provision of this Disclosure Agreement, the Trustee, at the written direction of the Participating Underwriter or the Holders of at least 25% in aggregate principal amount of Outstanding Bonds, shall, but only to the extent the Trustee receives indemnification to its satisfaction, or any Beneficial Holder or Holder of any of the Bonds may, seek mandate or specific performance by court order, to cause the Borrower, the Lessee, the Dissemination Agent or the Trustee, as the case may be, to comply with its obligations under this Disclosure Agreement; provided that none of the Borrower, the Lessee, the Dissemination Agent or the Trustee shall be liable for monetary damages or any other monetary penalty or payment for breach of any of its obligations under this Section or unless, in the case of the Borrower, such breach shall have been willful or reckless. A default under this Disclosure Agreement shall not be deemed an Event of Default under the Loan Agreement or the Indenture, and the rights and remedies provided by the Lease upon the occurrence of an "Event of Default" shall not apply to any such failure. The sole remedy under this Disclosure Agreement in the event of any failure of the

Borrower, the Lessee, the Dissemination Agent or the Trustee to comply with this Disclosure Agreement shall be an action to compel performance.

**Section 10. Duties, Immunities and Liabilities of Trustee and Dissemination Agent.** Article VIII of the Indenture is hereby made applicable to this Disclosure Agreement as if this Disclosure Agreement were (solely for this purpose) contained in the Indenture and the Dissemination Agent shall be entitled to the benefits, protections, rights and provisions thereof to the same extent as the Trustee. The Dissemination Agent (if other than the Trustee or the Trustee in its capacity as Dissemination Agent) and the Trustee shall have only such duties as are specifically set forth in this Disclosure Agreement, and the Borrower agrees to indemnify and save the Dissemination Agent and the Trustee and their officers, directors, employees and agents harmless against any loss, expense and liabilities which they may incur arising out of or in the exercise or performance of their powers and duties hereunder, including the costs and expenses (including attorneys' fees and expenses) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's or Trustee's respective negligence or willful misconduct. The Dissemination Agent and Trustee shall be paid compensation by the Borrower for their services provided hereunder and all expenses, legal fees and advances made or incurred by the Dissemination Agent hereunder. The Dissemination Agent and Trustee shall have no duty or obligation to review any information provided to it by the Borrower hereunder and shall not be deemed to be acting in a fiduciary capacity for the Borrower, the Holders or Beneficial Holders of the Bonds or any other party. The obligations of the Borrower under this Section shall survive resignation or removal of the Dissemination Agent or Trustee and payment of the Bonds.

**Section 11. Beneficiaries.** This Disclosure Agreement shall inure solely to the benefit of the Borrower, the Trustee, the Dissemination Agent, the Participating Underwriter and the Beneficial Holders and Holders of any Bonds and shall create no rights in any other person or entity.

**Section 12. Interpretation.** It being the intention of the Borrower that there be full and complete compliance with the Rule, this Disclosure Agreement shall be construed in accordance with the written guidance and no action letters published from time to time by the Securities and Exchange Commission and its staff with respect to the Rule.

**Section 13. Governing Law.** This Disclosure Agreement shall be governed by the laws of the State of California.

**Section 14. Counterparts.** This Disclosure Agreement may be executed in several counterparts, each of which shall be an original and all of which shall constitute but one and the same instrument.

[Remainder of Page Intentionally Left Blank]

[Borrower's Signature Page to Disclosure Agreement]

**MPM Sherman Way LLC,**  
a California limited liability company

By: **MAGNOLIA PROPERTIES MANAGEMENT,  
INC.,** its Sole Member

By: \_\_\_\_\_  
Authorized Representative

[Trustee and Dissemination Agent's Signature Page to Disclosure Agreement]

**THE BANK OF NEW YORK MELLON TRUST  
COMPANY, N.A.,** as Dissemination Agent

By: \_\_\_\_\_  
Authorized Officer

[The Lessee's Signature Page to Disclosure Agreement]

**MAGNOLIA EDUCATIONAL & RESEARCH  
FOUNDATION,**

a California nonprofit public benefit corporation

By: \_\_\_\_\_  
Name:  
Title:



**EXHIBIT A**

**NOTICE TO REPOSITORIES OF FAILURE TO FILE ANNUAL REPORT**

Name of Issuer: California School Finance Authority

Name of Bond Issue: \$5,675,000 California School Finance Authority School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project) Series 2014A; and  
\$345,000 California School Finance Authority School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project) Series 2014B (Taxable)

Name of Obligated Person: MPM Sherman Way LLC

Date of Issuance: June 26, 2014

CUSIP No: \_\_\_\_\_

NOTICE IS HEREBY GIVEN that MPM Sherman Way LLC (the "Borrower") has not provided an Annual Report with respect to the above-named Bonds as required by the Loan Agreement, dated as of June 1, 2014, between the Issuer and the Borrower. The Borrower has informed the Dissemination Agent that it anticipates that the Annual Report will be filed by \_\_\_\_\_.

Dated: \_\_\_\_\_

**THE BANK OF NEW YORK MELLON TRUST  
COMPANY, N.A., as Dissemination Agent**

By: \_\_\_\_\_  
Authorized Representative

## EXHIBIT B

### FORM OF CERTIFICATE FOR ANNUAL FILING OF CERTAIN OPERATING COVENANTS

Name of Issuer: California School Finance Authority

Name of Bond Issue: \$5,675,000 California School Finance Authority  
School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda  
Project) Series 2014A; and  
  
\$345,000 California School Finance Authority School Facility Revenue  
Bonds (Magnolia Science Academy-1, Reseda Project) Series 2014A

Dissemination Agent: The Bank of New York Mellon Trust Company, N.A.

Name of Borrower: MPM Sherman Way LLC

Date of Issuance: June 26, 2014

NOTICE IS HEREBY GIVEN that the Lessee is providing to the Dissemination Agent the following operational information as required under Section 4(a) of the Continuing Disclosure Agreement, dated as of June 1, 2014 (the "Disclosure Agreement"), between the Dissemination Agent and the Borrower. The Disclosure Agreement requires that the Borrower provide this information to the Dissemination Agent within one hundred eighty (180) days of the end of each fiscal year. Defined terms used in this certificate and not defined herein shall have the meanings granted to such terms in the Indenture, dated as of June 1, 2014 (the "Indenture"), by and between the Authority and The Bank of New York Mellon Trust Company, N.A., as trustee. The information contained below is unaudited.

1. As of June 30, 20\_\_, Lessee's:
  - (a) Cash on Hand was equal to \$\_\_\_\_\_.
  - (b) The amount of Cash on Hand required to comply with the covenant contained in Section 28 of the Lease Agreement for current fiscal year is equal to \_\_\_\_ days and the Lessee [is/is not] in compliance with such covenant.
  - (c) The Lessee's Debt Service Coverage Ratio for fiscal year 20\_\_ was \_\_\_\_x and the Lessee [is/is not] in compliance with such covenant.

2. Current and Projected Enrollment

| Grade            | 20__ - __ | 20__ - __ | 20__ - 20__ | 20__ - __ | 20__ - __ | (School<br>Years) |
|------------------|-----------|-----------|-------------|-----------|-----------|-------------------|
| 6th              |           |           |             |           |           |                   |
| 7th              |           |           |             |           |           |                   |
| 8th              |           |           |             |           |           |                   |
| 9th              |           |           |             |           |           |                   |
| 10th             |           |           |             |           |           |                   |
| 11 <sup>th</sup> |           |           |             |           |           |                   |
| 12 <sup>th</sup> |           |           |             |           |           |                   |
| Total            |           |           |             |           |           |                   |

3. Enrollment Waitlist as of November 1, 20\_\_

| Grade            |
|------------------|
| 6th              |
| 7th              |
| 8th              |
| 9th              |
| 10th             |
| 11 <sup>th</sup> |
| 12 <sup>th</sup> |
| Total            |

This certificate is being provided by the Lessee to the Dissemination Agent on a date which is [before][after] December 15<sup>th</sup>.

Dated: \_\_\_\_\_

**MAGNOLIA EDUCATIONAL & RESEARCH  
FOUNDATION,**  
a California nonprofit public benefit corporation

By: \_\_\_\_\_  
Name:  
Title:

## APPENDIX E

### BOOK-ENTRY SYSTEM

*The information in this Appendix has been provided by DTC for use in securities offering documents, and neither the Authority nor the Borrower take no responsibility for the accuracy or completeness thereof. The Authority and the Borrower cannot and do not give any assurances that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owner either (a) payments of interest, principal or premium, if any, with respect to the Bonds or (b) certificates representing ownership interest in or other confirmation of ownership interest in the Bonds, or that they will so do on a timely basis or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Limited Offering Memorandum. The current “Rules” applicable to DTC are on file with the Securities and Exchange Commission and the current “Procedures” of DTC to be followed in dealing with DTC Participants are on file with DTC. As used in this appendix, “Securities” means the Bonds, “Issuer” means the Authority and the Borrower.*

The Depository Trust Company (“DTC”), New York, New York, will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each maturity of each Series of Bonds, each in the aggregate principal amount of that maturity of Bonds, and will be deposited with DTC.

DTC, the world’s largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has a Standard & Poor’s rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com). and [www.dtc.org](http://www.dtc.org).

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC’s records. The ownership interest of each actual purchaser of each Bond (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on

behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not affect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Bonds unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Authority or the Trustee, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Trustee, or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Bonds at any time by giving reasonable notice to the Authority or the Trustee. Under such circumstances, in the event that a successor depository is not obtained, Bond certificates are required to be printed and delivered.

The Authority may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered to DTC.

The information in this Appendix concerning DTC and DTC's book-entry system has been obtained from sources that the Borrower believes to be reliable, but neither the Authority nor the Borrower take responsibility for the accuracy thereof.

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## APPENDIX F

### FORM OF OPINION OF BOND COUNSEL

\_\_\_\_\_, 2014

California School Finance Authority  
Los Angeles, California

California School Finance Authority  
School Facility Revenue Bonds  
(Magnolia Science Academy-1, Reseda Project)  
Series 2014A

and

California School Finance Authority  
School Facility Revenue Bonds  
(Magnolia Science Academy-1, Reseda Project)  
Series 2014B (Taxable)  
\_\_\_\_\_  
(Final Opinion)

Ladies and Gentlemen:

We have acted as bond counsel to the California School Finance Authority (the “Authority”) in connection with the issuance of \$5,675,000 aggregate principal amount of California School Finance Authority School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project) Series 2014A (the “2014A Bonds”) and \$345,000 aggregate principal amount of California School Finance Authority School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project) Series 2014B (Taxable) (the “2014B Bonds” and, together with the 2014A Bonds, the “Bonds”). The Bonds are issued pursuant to an Indenture, dated as of June 1, 2014 (the “Indenture”), between the Authority and The Bank of New York Mellon Trust Company, N.A., as trustee (the “Trustee”). The Indenture provides that the Bonds are issued for the stated purpose of making a loan of the proceeds thereof to MPM Sherman Way LLC, a California limited liability company (the “Borrower”), whose sole member is Magnolia Properties Management, Inc., a California nonprofit public benefit corporation (the “Sole Member”) pursuant to a Loan Agreement, dated as of June 1, 2014 (the “Loan Agreement”), between the Authority and the Borrower. Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Indenture.

In such connection, we have reviewed the Indenture, the Loan Agreement, the Intercept Notice, the Lease Agreement, dated as of June 1, 2014, between the Borrower, as lessor, and Magnolia Educational & Research Foundation, a California nonprofit public benefit corporation (the “School”), as lessee (the “Lease Agreement”), the Tax Certificate and Agreement, dated the date hereof, executed by the Authority, the Borrower, the Sole Member and the School (the “Tax Certificate”), opinions of counsel to the Authority, the Sole Member, the Borrower, the School

and the Trustee, certificates of the Authority, the Sole Member, the Borrower, the Trustee and others, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

We have relied on the opinion of Musick Peeler & Garrett LLP, Los Angeles, California, counsel to the Borrower, the Sole Member and the School, regarding, among other matters, the current qualification of the Sole Member and the School as organizations described in Section 501(c)(3) of the Internal Revenue Code of 1986 (the “Code”), and the status of the School as a charter school organized under the Charter School Law. We note that the opinion to the Borrower, the Sole Member and the School is subject to a number of qualifications and limitations. We have also relied upon representations of the Borrower, the Sole Member and the School regarding the use of the facilities financed or refinanced with the proceeds of the 2014A Bonds in activities that are not considered unrelated trade or business activities of the Sole Member or the School, respectively, within the meaning of Section 513 of the Code. We note that the opinion of counsel to the Borrower, the Sole Member and the School does not address Section 513 of the Code. Failure of the Sole Member or the School to be organized and operated in accordance with the Internal Revenue Service’s requirements for the maintenance of its status as an organization described in Section 501(c)(3) of the Code, or use of the bond-financed or refinanced facilities in activities that are considered unrelated trade or business activities of the Sole Member or the School within the meaning of Section 513 of the Code, may result in interest on the 2014A Bonds being included in gross income for federal income tax purposes, possibly from the date of issuance of the 2014A Bonds.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Accordingly, this letter speaks only as of its date and is not intended to, and may not, be relied upon or otherwise used in connection with any such actions, events or matters. Our engagement with respect to the Bonds has concluded with their issuance, and we disclaim any obligation to update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the Authority. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents, and of the legal conclusions contained in the opinions, referred to in the second and third paragraphs hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Indenture, the Loan Agreement, the Lease Agreement, the Intercept Notice and the Tax Certificate, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the 2014A Bonds to be included in gross income for federal income tax purposes. In addition, we have assumed that actions of the Borrower, the Sole Member, the School and other persons will not cause any of the 2014A Bonds to exceed the \$150,000,000 limitation on qualified 501(c)(3) bonds that do not finance hospital facilities set forth in Section 145(b) of the Code. We call attention to the fact that the rights and obligations under the Bonds, the Indenture, the Loan Agreement, the Lease Agreement, the Intercept Notice and the Tax Certificate and their enforceability may be subject to bankruptcy, insolvency,

receivership, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to the limitations on legal remedies against instrumentalities of the State of California. We express no opinion with respect to any indemnification, contribution, liquidated damages, penalty (including any remedy deemed to constitute a penalty), right of set-off, arbitration, judicial reference, choice of law, choice of forum, choice of venue, non-exclusivity of remedies, waiver or severability provisions contained in the foregoing documents, nor do we express any opinion with respect to the state or quality of title to or interest in any of the real or personal property described in or as subject to the lien of the Indenture, the Loan Agreement, the Lease Agreement or the accuracy or sufficiency of the description contained therein of, or the remedies available to enforce liens on, any such property. Our services did not include financial or other non-legal advice. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Limited Offering Memorandum relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The Bonds constitute the valid and binding limited obligations of the Authority.
2. The Indenture has been duly executed and delivered by, and constitutes the valid and binding obligation of, the Authority. The Indenture creates a valid pledge, to secure the payment of the principal of and interest on the Bonds, of the Payments (except Payments pursuant to the Intercept Notice) and any other amounts held by the Trustee in any fund or account established pursuant to the Indenture, except the Rebate Fund and the Repair and Replacement Fund, subject to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture. The Bonds are further secured by apportionments from the State Controller, pursuant to Section 17199.4(a)(4) of the Education Code and the Intercept Notice, of amounts specified in the Intercept Notice and paid directly to the Trustee.
3. The Loan Agreement has been duly executed and delivered by, and constitutes a valid and binding agreement of, the Authority.
4. Interest on the 2014A Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. Interest on the 2014A Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although we observe that it is included in adjusted current earnings when calculating corporate alternative minimum taxable income. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Bonds.

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

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## APPENDIX G

### FORM OF INVESTOR LETTER

California School Finance Authority  
Sacramento, California

The Bank of New York Mellon Trust Company, N.A.  
Los Angeles, California

Re: \$\_\_\_\_\_ California School Finance Authority  
School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project),  
Series 2014A and Series 2014B (Taxable)

Ladies and Gentlemen:

The undersigned (the “Investor”) hereby acknowledges that it is purchasing \$\_\_\_\_\_ aggregate principal amount of California School Finance Authority (the “Authority”) School Facility Revenue Bonds (Magnolia Science Academy-1, Reseda Project) Series 2014[A/B] (the “Bonds”), issued pursuant to an indenture, dated as of June 1, 2014 (the “Indenture”), between the Authority and The Bank of New York Mellon Trust Company, N.A., as Trustee (the “Trustee”). Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Indenture.

The undersigned acknowledges that the Bonds are being delivered for the purpose of financing the acquisition, construction, improvement and equipping of certain charter school facilities located in Los Angeles, California (the “Project”), on behalf of MPM Sherman Way LLC (the “Borrower”), as more particularly described in the Indenture. The Project will be leased to Magnolia Educational & Research Foundation, a California nonprofit public benefit corporation, also known as Magnolia Public Schools, as Lessee (the “Lessee”) pursuant to a Lease Agreement dated as of June 1, 2014 by and between the Borrower and the Lessee. The sole member of the Borrower is Magnolia Properties Management, Inc., a California nonprofit public benefit corporation.

In connection with the sale of the Bonds to the Investor, the Investor hereby makes the following representations upon which you may rely:

1. The Investor has authority and is duly authorized to purchase the Bonds and to execute this letter and any other instruments and documents required to be executed by the Investor in connection with the purchase of the Bonds.
2. The Investor is a “qualified institutional buyer” as defined in Rule 144A of the Securities Act of 1933, as amended (the “Act”), and therefore has sufficient knowledge and experience in financial and business matters, including in the purchase and ownership of municipal obligations, to be able to evaluate the risks and merits of the investment represented by the Bonds.
3. The Bonds are being acquired by the Investor for investment and not with a view to, or for resale in connection with, any distribution of the Bonds, and the Investor intends to hold the Bonds solely for its own account for investment purposes for an indefinite period of time, and does not intend at this time to dispose of all or any part of the Bonds. However, the Investor may sell the Bonds at any time the Investor deems appropriate, subject to the transfer restrictions set forth in the Bonds and in the Indenture. The

Investor understands that it may need to bear the risks of this investment for an indefinite time, since a sale of the Bonds, or any portion thereof, prior to maturity may not be possible.

4. The Investor understands that the Bonds are not registered under the Act and that such registration is not legally required as of the date hereof and further understands that the Bonds (a) are not being registered or otherwise qualified for sale under the “Blue Sky” laws and regulations of any state, (b) will not be listed in any stock or other securities exchange, and (c) will be delivered in a form which may not be readily marketable.

5. The Investor acknowledges that it has either been supplied with or been given access to information, including financial statements and other financial information, to which a reasonable investor would attach significance in making investment decisions, and the Investor has had the opportunity to ask questions and receive answers from knowledgeable individuals, including its own counsel, concerning the Borrower, the Project, the Lessee and the Bonds and the security therefor so that, as a reasonable investor, the Investor has been able to make its decision to purchase the Bonds. The Investor has received a copy of the Preliminary Limited Offering Memorandum, dated June 3, 2014, as supplemented by the Supplement thereto, dated June 13, 2014, and the Limited Offering Memorandum, dated June 18, 2014, relating to the Bonds. The Investor acknowledges that it has not relied upon any advice, counsel, representation or information of the Authority in connection with the Investor’s purchase of the Bonds.

6. The Investor acknowledges that the obligations of the Authority under the Indenture are special, limited obligations payable solely from amounts paid to the Authority from the Borrower pursuant to the terms of the Loan Agreement and the Authority shall not be directly or indirectly or contingently or morally obligated to use any moneys or assets of the Authority for amounts due under the Indenture. The Investor understands that the Bonds are not secured by any pledge of any moneys received or to be received from taxation by the Authority (which has no taxing power), the State of California or any political subdivision or taxing district thereof; that the Bonds will never represent or constitute a general obligation or a pledge of the faith and credit of the Authority, the State of California or any political subdivision thereof; that no right will exist to have taxes levied by the State of California or any political subdivision thereof for the payment of principal of and interest on the Bonds and that the liability of the Authority and the State of California with respect to the Bonds is subject to further limitations as set forth in the Bonds and the Indenture.

7. The Investor has made its own inquiry and analysis with respect to the Bonds and the security therefor, and other material factors affecting the security and payment of the Bonds. The Investor is aware that the business of the Borrower and the Lessee involves certain economic and regulatory variables and risks that could adversely affect the security for the Bonds.

8. The Investor agrees to indemnify and hold harmless the Authority with respect to any claim asserted against the Authority that arises solely and directly as a result of our sale, transfer or other disposition of the Bonds in violation of the provisions hereof, other than any claim that is based upon the willful misconduct of the Authority.

9. The Investor agrees that it is bound by and will abide by the provisions of the Indenture relating to transfer, the restrictions noted on the face of the Bonds and this Investor Letter. The Investor also covenants to comply with all applicable federal and state securities laws, rules and regulations in connection with any resale or transfer of the Bonds by the Investor.

10. The Investor acknowledges that the sale of the Bonds to the Investor is made in reliance upon the certifications, representations and warranties herein by the addressees hereto.

11. The Investor hereby waives any and all claims, actions, or causes of action which the Investor may have from and after the date hereof against the Authority, counsel to the Authority, and their respective members, officers, agents, and employees, growing out of any action (other than willful

misconduct) which the Authority took or could have taken in connection with the authorization, execution, delivery, and sale of the Bonds or the purchase of the Bonds by the undersigned or in connection with any statements or representations which induced the undersigned to purchase the Bonds.

12. The interpretation of the provisions hereof shall be governed and construed in accordance with California law without regard to principles of conflicts of laws.

Dated: \_\_\_\_\_

Very truly yours,

[NAME OF INVESTOR]

By:

\_\_\_\_\_

Name:

\_\_\_\_\_

Title:

\_\_\_\_\_