

**MINUTES
of the
FIFTY-EIGHTH MEETING
of the
PUBLIC SCHOOL CAPITAL OUTLAY OVERSIGHT TASK FORCE**

**October 20, 2016
Room 322, State Capitol
Santa Fe**

The fifty-eighth meeting of the Public School Capital Outlay Oversight Task Force (PSCOOTF) was called to order by Senator John M. Sapien, chair, on October 20, 2016 at 10:20 a.m. in Room 322 at the State Capitol in Santa Fe.

Present

Sen. John M. Sapien, Chair
Rep. Dennis J. Roch, Vice Chair
Dep. Sec. Paul Aguilar, Public Education
Department
Dr. Carl Foster
Rep. Harry Garcia
Dr. Reinaldo Garcia
Kirk Hartom
Sen. Stuart Ingle
Rep. Larry A. Larrañaga
Rep. James Roger Madalena
Acting Secretary Duffy Rodriguez,
Department of Finance and
Administration
Stan Rounds
Sen. Benny Shendo, Jr.
Sen. John Arthur Smith
Sen. Mimi Stewart, designee for Sen. Mary
Kay Papen

Advisory Members

Rep. Eliseo Lee Alcon
Sen. Howie C. Morales
Sen. Cliff R. Pirtle

Absent

Rep. Sharon Clahchischilliage
Randall Earwood
Rep. Yvette Herrell
Sen. Mary Kay Papen
T.J. Parks
Mike Phipps
Sen. Sander Rue
Rep. Don L. Tripp

Sen. Daniel A. Ivey-Soto
Rep. D. Wonda Johnson
Rep. Patricia Roybal Caballero
Rep. Patricio Ruiloba
Sen. William E. Sharer
Rep. James E. Smith
Sen. William P. Soules
Sen. Pat Woods

Staff

Raúl E. Burciaga, Director, Legislative Council Service (LCS)

Sharon S. Ball, Senior Researcher, LCS

Jeff Eaton, Research and Fiscal Policy Analyst, LCS

Michelle Jaschke, Researcher, LCS

Guests

The guest list is in the meeting file.

Handouts

Copies of all handouts are in the meeting file.

Thursday, October 20**Welcome and Approval of Minutes**

The chair welcomed members and guests and asked that the members introduce themselves. On a motion duly made and seconded, the minutes of the fifty-seventh meeting of the PSCOOTF were approved without objection.

PSCOOTF Resource Booklet Update

Ms. Ball presented an overview of the information contained in the PSCOOTF Resource Booklet. Ms. Ball noted that much of the information is updated annually, including information on the Severance Tax Permanent Fund (STPF) from the State Investment Council (SIC), award offset information and Facility Condition Index (FCI) rankings from the Public Education Department (PED) and a range of relevant tax information from the Department of Finance and Administration. The booklet includes historical material tracing the PSCOOTF's roots back to 1998, when the *Zuni* lawsuit was filed, as well as the 2002 report of the special master in that case. The booklet is posted on the legislature's website and is available as a publication from the LCS.

Public School Capital Outlay Council (PSCOC) Revenue Stream Update: SIC Report

Steven K. Moise, state investment officer, SIC, and Charles Wollmann, director of communications and legislative affairs, SIC, updated task force members on the status of the PSCOC revenue stream. Mr. Moise provided an overview of the assets under management by the SIC, including the Land Grant Permanent Fund (LGPF), the STPF, the Tobacco Settlement Permanent Fund (TSPF) and the Water Trust Fund. In addition, the SIC manages the assets of other government clients who have been drawn to the economies of scale offered by the SIC. Combined fund values for all of these funds and governmental client assets as of August 30, 2016 total \$20.61 billion.

Mr. Moise presented a detailed breakout of investment allocation and investment performance over time as of August 31, 2016. He observed that despite strong stock performance in July and August of this year, performance overall is still below investment

targets. A target investment return of seven percent is set for the LGPF, and a target of 6.75 percent is set for the STPF. Last year, the SIC reduced its expectations for returns in anticipation of the low-return environment ahead. Inflows to the permanent funds are expected to stay below average for some time, largely because of falling gas and oil prices. Mr. Moise reported that investments must earn more in the face of diminished inflows in order to prevent dipping into the corpus of the funds. A summary of the widely varying returns and inflows and outflows over the past five years was presented. Mr. Moise reported that the rolling five-year average used to determine distributions from the permanent funds is an important tool that helps to stabilize the corpus of the funds over time.

Task force members and SIC staff discussed the impact of House Bill (HB) 236, passed during the 2015 legislative session to increase inflows to the STPF from the current five percent to a target of nearly 14 percent in fiscal year (FY) 2022 through a number of phased-in reductions to beneficiary set-asides. A member noted that the reductions to the Public School Capital Outlay Fund (PSCOF) will not begin to be phased in for two more years, and that, therefore, the real impact of the HB 236 reductions has yet to be assessed. Mr. Wollmann agreed that the SIC needs time to assess the full effect of HB 236 before any further reductions are made to distributions.

Mr. Wollmann proceeded to outline some of the SIC's investment strategies, including the New Mexico Private Equity Investment Program (NMPEIP). He reported that the early years of the program focused on economic development, but current strategy prioritizes financial return over job creation. He reported that the NMPEIP has proven to be a valuable component of the SIC portfolio, bringing an additional \$6.00 in outside investment in venture capital activities for start-up companies for each SIC dollar invested. The SIC can invest up to nine percent of the STPF in the NMPEIP, although the current target is five percent. Statutory changes included in Senate Bill 15, passed during the 2016 regular legislative session, removed the requirement that NMPEIP participants have an in-state office or in-state staffing.

In summary, Mr. Moise reported that the seven- to 10-year macroeconomic and financial market outlooks are challenging. A doubly negative impact on the funds is anticipated, with downturns in both inflows and returns on investment. In response to members' questions regarding the cost of investing, Mr. Wollmann reported a total SIC budget of \$51 million, and a management fee average of one-fourth percent of the funds managed. Mr. Moise stated that he would work on breaking out a figure from the \$51 million budget to address the cost-of-investing question by providing a specific dollar amount. The chair noted that one-fourth percent is significantly less than a standard management fee of four percent to six percent for investments. Members also raised questions regarding the possibility of a bond ratings reduction for the state. SIC staff indicated that the planned use of the TSPF to cover the past fiscal year expenses could have repercussions in the bond ratings arena. A task force member noted that the state legislature has made difficult decisions in the face of reduced revenues, but that those difficult decisions will help to protect the state's current excellent bond rating.

PSCOC Financial Plan

Denise Irion, chief financial officer, Public School Facilities Authority (PSFA), presented an update to the PSCOC financial plan. Ms. Irion noted that the PSCOF has experienced weakened revenues and that the forecast is for continued long-term reductions. Revenue forecasts for FY 2016 through FY 2020 have decreased by an additional 5.2 percent for a total reduction of 16.5 percent since FY 2015.

The standards-based program now in effect has dramatically reduced the statewide FCI, according to Ms. Irion. In 2001, the average statewide FCI was 71 percent, but now stands at 32 percent (lower is better). Moving forward with the building systems initiative, Ms. Irion reported that it is possible to maintain the FCI range in the mid-30s with fewer capital dollars than have been invested in the past. This will, however, require good facility planning and management, as well as improved district facility maintenance efforts.

Ms. Irion was joined by David Abbey, director, Legislative Finance Committee, and chair, PSCOC, who announced the pending retirement of Robert Gorrell, director, PSFA, eight months hence. Mr. Abbey reported the excellent work of the PSCOC and PSFA staff in working toward a transition from a focus on the standards-based building program to a focus on a building systems program. In response to member questions, Mr. Abbey reported that staff have been trained and that a methodology for the building systems initiative has been developed. Mr. Gorrell observed that the PSFA has been moving toward this transition for years and is well-equipped with tools such as the Facilities Maintenance Assessment Report to proceed with the transition. As with the standards-based program, Mr. Abbey observed that piloting the building systems initiative is likely to require some experimentation.

Members raised questions regarding the purchase and use of portable buildings, the adequacy of emergency reserve funds and progress toward developing maintenance cost codes and appropriately training school maintenance workers to use them. Mr. Gorrell stated that the PSFA would look at all possible means to use existing portable facilities where needed and where cost-effective before purchasing any new portable buildings. Mr. Abbey stated that the PSCOC will work on plans to address the Construction Industries Division of the Regulation and Licensing Department's training requirements for maintenance workers and the need for maintenance cost codes to further the work of districts and the PSFA in facilities maintenance. He further observed that with respect to emergency reserve funds, the outlook is "tight but not impossible", at least until FY 2018.

Charter Schools' Facilities Issues

Rachel Gudgel, director, Legislative Education Study Committee, presented information on a range of charter school facilities issues. She reported that despite decreased revenue for public school projects, lease-assistance funding requests continue to grow as the number of charter schools continues to grow. She noted that lease-assistance funding is not mandatory and the program lacks adequate controls. Statute allows the PSCOC to make awards from the

PSCOF for lease payments for classroom facilities leased by school districts and charter schools. Lease-assistance funding has increased from \$2 million to \$16 million over the past 10 years.

Ms. Gudgel also reviewed the requirements for charter schools to be located in public facilities. As of July 1, 2015, in order for a new charter school to open or for a school to renew its charter, the school must meet one of the following requirements:

- be housed in a public facility that is owned by the charter school, the school district, the state, an institution of the state, another political subdivision of the state, the federal government, or one of its agencies, or a tribal government;
- be subject to a PED-approved lease-purchase agreement;
- be located in a facility that meets the statewide adequacy standards and the owner of the facility is contractually obligated to maintain those standards at no additional cost to the charter school or the state and other public buildings are not available or adequate for the educational program of the charter school; or
- be located in a facility that meets the statewide adequacy standards and the owner of the facility is contractually obligated to maintain those standards at no additional cost to the charter school or the state and the owner of the facility is a nonprofit entity specifically organized for the purpose of providing the facility for the charter school.

According to Ms. Gudgel, 103 charter school lease applications were submitted in FY 2016. A PSCOC review of those lease applications revealed that 78 charter schools were in compliance with the public building requirements (either because they are not yet subject to the requirements or they meet one of the four enumerated facility agreements) and had submitted all required documentation. Twenty-five charter schools were not in compliance with the public building requirements or did not submit required documentation. Many specific compliance issues were noted. Ms. Gudgel reported that next steps may include coordination between the PSCOC and the PSFA to streamline the review process and identify issues that require legislative attention. One of those issues may be a requirement for a uniform, standardized lease agreement.

Ms. Gudgel wanted to make the point that the requirement to be in a public building in Section 22-8B-4 NMSA 1978 and the requirement to be in a "public school building" pursuant to Section 22-8B-4.2 NMSA 1978 are actually a "rolling" requirement because the requirement goes into effect when a new school is chartered or when an existing school applies for renewal of a charter into the requirement over a period of several years. That is, the need to renew differs among charter schools depending on when their last renewal was issued by the PED. She added that the statutory language has been confusing to some of her client charter schools.

Continuing, Patricia Matthews, Esq., charter school legal counsel, Matthews Fox, discussed concerns with the PED's lack of timely approval of lease-purchase arrangements. She explained that these funding mechanisms give charter schools an opportunity to use capital improvement funds generated through direct mill levies (with school district and voter approval)

in addition to operational funds to make facility improvements. Ms. Matthews explained that it is a way to comply with Section 22-8B-4.2 NMSA 1978 under the statutory deadlines.

In response to task force questions and comments, Mr. Aguilar discussed some concerns with statutory language that might alleviate some of the PED's concerns. He also noted that some charter school foundations have gone ahead and made lease-purchase agreements with certain vendors without having their proposals approved by the department, which means they have committed public funds without meeting certain requirements.

Ms. Gudgel said that, speaking as a member of the PSCOC, she is concerned that some charter schools have entered into straight leases with a simple agreement to purchase the building at a fixed price, which does not meet statutory requirements.

A member requested a copy of the Legislative Education Study Committee report and Ms. Matthews' rebuttal letter, which Ms. Matthews mentioned in her presentation. Ms. Gudgel noted that, currently, both the report and rebuttal letter are under review, and, as a result, are not ready for distribution. She explained that the report will be ready once corrections have been completed.

During discussion, several members mentioned concerns about the ultimate ownership of charter school properties if, for some reason, a charter school closes, expressing particular concerns about the ownership by foundations when taxpayers' dollars have paid for the facilities.

Given the complexity of the issue and time constraints for some panel members, the task force agreed to continue this discussion at the next PSCOOTF meeting, which is scheduled for November 14, 2016.

Adjournment

Members agreed to postpone hearing the final agenda item until the next meeting. There being no further business before the task force, the fifty-eighth meeting of the PSCOOTF adjourned at 1:30 p.m.