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F I S C A L   I M P A C T   R E P O R T

SPONSOR Beffort
ORIGINAL DATE 02/13/12
LAST UPDATED 03/11/13
HB

SHORT TITLE School Leases & Interest Conflicts
SB 333/aSEC/aSJC/aSFl#1

ANALYST Gudgel/Canney

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY13	FY14	FY15	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$95.5	$95.5	$286.5	Recurring	PSFA Operating

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to HB 273, Public School Capital Outlay Lease Payments (Stapleton) makes the CPI adjustment for the lease assistance program optional.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Public School Facilities Authority (PSFA)
Public Education Department (PED)
Regulation and Licensing Department (RLD)
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of SFl Amendment #1

The Senate Floor Amendment to Senate Bill 333 as amended by Senate Judiciary Committee makes the changes of the bill effective for lease reimbursement payments for leases, limits lease reimbursement payments for leases, amendments and renewals entered into after July 1, 2014.

Synopsis of SJC Amendment

The Senate Judiciary Committee amendment to Senate Bill 333 as amended by Senate Education Committee strikes all Senate Education Committee Amendments and limits lease reimbursement payments for leases, amendment and renewals entered into after July 1, 2013 to be made for leases developed prior to execution in consultation with the Public School Capital Outlay Council.

Synopsis of SEC Amendment

The Senate Education Committee amendment to Senate Bill 333 eliminates new language in the original bill that limited lease reimbursement payments for base rent only that has been preapproved by the Public School Capital Outlay Council (PSCOC).

Synopsis of Original Bill

Senate Bill 333 (SB 333) amends the Charter Schools Act and the Public School Capital Outlay Act to do the following:

- require the PSCOC to approve leases between a school district and a charter school at local market rates, but not exceeding the per MEM amount established by the PSCOC.
- require charter schools to attain, within 18 months of occupancy or relocation, a rating equal to or better than the average New Mexico Condition Index.
- extends the conflict of interest provisions of Section 22-8B-5.2 NMSA 1978 to employees of charter schools and makes contracts void where a conflict exists.
- requires the chartering authority (local school board or the Public Education Commission) to review and approve all charter school conflict-of-interest disclosure statements.
- requires the PSCOC to develop a standardized lease for use by all charter schools for new leases, amendments, and renewals beginning July 1, 2013, and prohibits the PSCOC from making lease assistance payments for anything but base rent for pre-approved leases using the approved standardized lease.

FISCAL IMPLICATIONS

SB 333 does not include an appropriation. It increases administrative oversight of charter school leases by the Public School Capital Outlay Council, and may have a minimal impact on the Public School Facilities Authority.

SIGNIFICANT ISSUES

Section 1(F) of Section 22-8B-4 NMSA 1978 of the Charter Schools Act currently requires school districts to provide charter schools with available facilities unless they're used for other educational purposes. During the 2007 legislative session, SB 395 was enacted to allow school districts to lease the available space to the charter schools, providing an incentive for school districts to share underutilized facilities. SB 333 amends Section 1(F) of 22-8B-4 NMSA 1978 to limit the amount school districts may charge, to rates approved by the PSCOC at the local market rate.

The Public Education Department (PED) stated that school districts have been leasing facilities to charter schools for the total amount allowed since the SB 395 was enacted. In addition, the PED reported that:

> This bill adds language that will prevent school districts from charging the total amount allowable under the formula and will only pay up to the market value. However, the PED also questioned who can or will set a local market rate, because of the different types of space needed for different charter schools. Costs associated with a vocational school may

differ greatly from costs associated with a performing arts school, and that setting a local market rate would be near impossible.

Section 2 of the bill requires new or relocated charter school facilities to meet a condition rating equal to or better than the current average for New Mexico public schools within eighteen months of occupancy or relocation. This changes the existing requirement that charter schools only “demonstrate” within eighteen months, a plan to achieve the same goal by an unspecified deadline.

The PSFA noted that adding the deadline now removes the open-ended condition that existed previously, there still may be issues to contend with due to the continuation of the provision allowing the school to lease and occupy the facility for eighteen months prior to fulfilling the facility condition requirement. These issues include consequences of non-compliance and the impact on learning during the 18-month window for improvement.

Section 3 of the bill extends the conflict of interest provisions of Section 22-8B-5.2 NMSA 1978 to employees of charter schools and makes contracts void where a conflict exists. Section 22-8B-5.2 NMSA 1978 is currently silent regarding conflicts of interests regarding charter school employees. The PED reported that a number of charter schools, their founders and some foundation members are directly involved or have a financial interest in facilities that the charter school contracts for facilities.

Section 4 requires the chartering authority – the local school board or the Public Education Commission (PEC) – to review and approve all charter school conflict-of-interest disclosure statements. The Department of Finance and Administration (DFA) and the PED reported that the PEC would review and approve state-chartered charter schools’ conflict of interest disclosure statements. Since the PEC does not have staff, this will have to be absorbed by the PED.

Section 5 of the bill amends the Public School Capital Outlay Act to require the PSCOC to develop a standardized facility lease for use by all charter schools for all new leases, amendments, and renewals entered into after July 1, 2013. The PED and DFA provided the following information regarding standardized leases:

Below is a chart that lists the total amount of lease payment assistance awards by fiscal year for the last seven years:

06-07	07-08	08-09	09-10	10-11	11-12	12-13	TOTAL
$5,221.8	$6,524.2	$7,306.5	$8,294.9	$9,751.7	$10,780.0	$13,087.2	$60,966.3

Given the amount of state funding distributed annually for lease payment assistance, it may be in the state’s best interest to incorporate a standardized lease that is reviewed and approved by the PSCOC prior to allocating any of these funds.

Section 5 of the bill also mandates that only base rent for leases approved by the PSCOC may be reimbursed. The PSFA suggested that base rent be defined in the bill, to clarify what is included and what is not.

The DFA and PED noted the following with regard to the inclusion of the term ‘base rent’, “It appears this would be an overstep on the part of the PSCOC where the Council would be in the business of approving leases and intruding into an area of responsibility of the local school boards. The Legislature should consider only requiring the use of standardized leases as a first step and spend the interim looking at what leases should include and what are allowable expenditures that should be contained in a lease.”

The Senate Education Committee amendment eliminated the term “base rent” and the requirement for the PSCOC to pre-approve the leases for lease assistance reimbursement. However, the Senate Judiciary Committee struck the Senate Education Committee amendment related to the PSCOC pre-approving leases for lease assistance reimbursement and inserted language limiting lease assistance reimbursement to leases that have been developed in consultation with the PSCOC prior to their execution. Increased oversight of leases will address issues raised in the LFC staff evaluation Public Schools Facilities Authority Charter School Facilities Lease Assistance and Capital Outlay Planning (January 14, 2013), noting questionable costs and expenses included in leases.

LFC staff evaluation Public Schools Facilities Authority Charter School Facilities Lease Assistance and Capital Outlay Planning (January 14, 2013), noted significant issues with charter school facility leases and recommended requiring **the PSCOC to develop and require the use of a standardized leases format and to use lease assistance only for base lease amounts, and prohibit the inclusion of any other costs**. Lease assistance costs have, on average, increased almost 22 percent per year for the past nine years and for FY13 total approximately $13.5 million in annual payments. ***Average lease rates are sometimes higher than market rates, and in certain cases appear to be excessive***, with foundations and third parties earning profits from subleases. Causes of high lease rates include profit taking by third parties, additional costs being included in base rents, schools contracting for space in excess of need, inadequate oversight of tenant improvements, and lack of accountability. Aside from the PSCOC deferring certain lease payments until high lease rates were justified, there have been no requirements for determining if lease cost, tenant improvements, or space needs are reasonable.

A**dditional costs and questionable space utilization are major factors in the high cost of charter school leases.** Expenses beyond base rent drive up lease payments for schools. Many tenant improvements, which are allowed after the charter’s first renewal, appear to be mismanaged, creating opportunities for waste and abuse. According to statute, additional lease payments *may* be used for leasehold improvements after a school’s first renewal, typically five years. Many tenant improvements, however, have occurred prior to the first renewal and appear to be mismanaged, creating opportunities for waste and abuse, and are included in leases.

Eligible costs for lease payments are not defined in regulation or statute. Types of costs that are allowable expenses for lease payments are not defined. Therefore schools routinely pay for a number of different expenses through lease payments. Types of expenses written into leases and paid for through lease payments include maintenance, facility and infrastructure repair, janitorial services, and utilities. These costs should be paid from a school’s operating budget, be separately accounted for, and not require funding from the PSCOC. In addition, charters pay for school foundation fees and expenses, and school foundation reserves, which require further scrutiny from the schools’ authorizer.

Issues noted in the LFC report highlight the need for increased oversight and a definition of "base rent". The full report can be read at:
http://www.nmlegis.gov/lcs/lfc/lfcdocs/perfaudit/Public%20Schools%20Facilities%20Authority.pdf

PERFORMANCE IMPLICATIONS

The PSFA reported that SB 333 increases oversight and consistency in the approval process related to new or relocated charter school facilities. Standardization of lease formats and procedures may streamline the current lease approval process for both the State and charters.

ADMINISTRATIVE IMPLICATIONS

The PSFA stated that the PSCOC and the PSFA will assume increased oversight responsibilities as a result of the bill. The Senate Education Committee amendment would reduce the administrative responsibilities of the PSFA to review all charter school leases, amendments, and renewals prior to awarding lease assistance. However, the Senate Judiciary Committee Amendment again increases oversight responsibilities but not to the level of the original bill.

RELATIONSHIP

HB 273 Public School Capital Outlay Lease Payments (Stapleton) makes the CPI adjustment for the lease assistance program optional.

TECHNICAL ISSUES

The title of the bill includes the word standardized lease "format". To be consistent, the word "format" should be added to "standardized lease" in Section 5(I).

The DFA and PED recommend the Legislature consider amending the bill to remove the base rent requirement. On page 16, strike "base rent for" and after leases, strike the rest of the line. On page 16, line 7, strike the first occurrence of "council". These amendments were adopted by the House Education Committee.

OTHER SUBSTANTIVE ISSUES

The LFC staff Program Evaluation of New Mexico Charter Schools (July 23, 2010) noted charter authorizers need increased oversight and monitoring of charter schools to ensure the academic and financial performance of schools, and the use of academic and financial watch lists could help facilitate this increase in profile for authorizers. Charter school site visits showed issues with regard to conflicts of interest among other things. Charter schools have operations that have the potential appearance of conflicts of interest with regard to lease arrangements, family hiring and other contractual arrangements. **The issues noted in the 2010 report, while not specific to employees of charter schools, raised concern over real and potential appearance of conflicts of interest.**

ALTERNATIVES

Reinsert the term “base rent” and provide a definition of base rent. This will ensure equitable lease assistance funding statewide, and will eliminate the potential to abuse lease assistance funding to pay for other expenses that should be paid out of operational dollars.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The PSFA asserts that, if the bill is not enacted:

- Charter school facility lease agreements will continue to be variable in scope and detail and inconsistent in what they cover.
- New and relocated charter schools might continue to occupy facilities that do not meet current average facility condition for New Mexico public schools for a period exceeding 18 months.
- The PSCOC will maintain its currently limited role in charter school lease approval and oversight.

RSG:JC/svb:blm