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

SPONSOR Beffort **ORIGINAL DATE** 2/18/15 **LAST UPDATED** 3/10/15 **HB**

SHORT TITLE Charter School Lease Approval **SB** 236/aSJC

ANALYST Chavez

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		See Fiscal Implications				

(Parenthesis ( ) Indicate Expenditure Decreases)

Conflicts with House Bill 253, Senate Bill 128

SOURCES OF INFORMATION
LFC Files

Responses Received From
Attorney General's Office (AGO)
Public School Insurance Authority (PSIA)
Public Education Department (PED)
Public School Facilities Authority (PSFA)

SUMMARY

Synopsis of SJC Amendment

The Senate Judiciary Committee amendment to Senate Bill 236 leaves current statutory language in place on page 10, lines 8 and 9 that would allow a chartering authority, PED, or the governing body of a charter school the option of voiding the contract of a member of a governing body or employee or a charter school in a situation where a conflict of interest exists for that person or for an immediate family member. The original bill would have rendered void the contract of any such person where a conflict of interest was found.

However, it is important to note the bill does make void a contract where a governing board member or employee has a conflict of interest and participates in the procurement process. Additionally, the bill requires the chartering authority to annually review and approve conflict of interest disclosures from an authorized charter school.

Synopsis of Bill

Senate Bill 236 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, 2015, and states the PSCOC may make lease assistance developed prior to execution in consultation with the Council using the approved standardized lease format.

FISCAL IMPLICATIONS

SB 236 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.

PSFA states "there will be additional review requirements and PSFA staff analysis to provide recommendations to the PSCOC about a lease award applicants lease rate a comparable local market rate. A contract service provider of local real estate data may be appropriate. It is unknown what the cost would be to procure the necessary expertise but may be as high as $50.0 annually." However, it is important to note PSFA requested and received funding for an expansion attorney in FY15. PSFA requested this position to manage a standardized lease requirement. In 2013, when the request was made, the Council was working to adopt and require a standardized lease. Despite receiving funding for the attorney position, PSFA has not filled the position to date. The FY16 budget for PSFA currently included in HB2 includes continued funding for the attorney position.

PED notes the Public School Capital Outlay Fund (PSCOF) is the source of funding for the standards-based capital outlay program for public schools statewide, as well as the state match for the Public School Capital Improvements Act (SB9), lease assistance program, master plan assistance, and other programs under the Public School Capital Outlay Act (Chapter 22, Article 24 NMSA1978). Revenues to the fund are principally from supplemental severance tax bonds and allocations from the fund are authorized by the PSCOC.

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 are 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 236 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.

PED states it is important to note that, as schools of choice, charter schools may have differences among each other regarding their building needs. Requiring that lease payments be made at the local market rate "may be near unachievable in that costs related to one schools' needs may be very different from another and the local market rate may not be sufficient to meet the costs of facilities needed to meet the charter schools' mission."

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. PED notes this requirement may be difficult to achieve, noting that requiring charter schools to meet or exceed the average of all public schools would indicate charter schools are being held to a higher standard than other public schools.

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. The SJC amendment restores language that would give PED, the chartering authority, or governing boards the option of rendering such contracts void. Section 22-8B-5.2 NMSA 1978 is currently silent regarding conflicts of interests regarding charter school employees.

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. Since the PEC does not have staff, this will have to be absorbed by the PED. PED notes the annual review required by the bill will help prevent any potential conflicts of interest. (See Other Substantive Issues for further discussion regarding conflict of interest.)

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, 2015. This section contains language that "For leases, amendments and renewals entered into after July 1, 2015, these payments may reimburse leases developed prior to execution in consultation with the council using the standardized lease format approved by the council." The exact legislative intent of this language is unclear.

PSFA notes that PSCOC developed a standardized lease in 2013, but its use is not a requirement. The standardized lease includes all variables in the documents to be compared from one lease to another, as well as other pertinent information. Under the standardized lease, all services except custodial work are to be paid for by the landlord unless specified in the front-end document.

PSFA adds requiring use of a standardized lease could benefit charter schools. However, if the standardized lease requirement is viewed as undesirable by the potential lessor, it could make the space unavailable to the charter school or drive the lease rate up for the added perceived inconvenience. PED also notes that since majority of all charter school leases are with private parties there may be some resistance from these private entities to use a standard format.

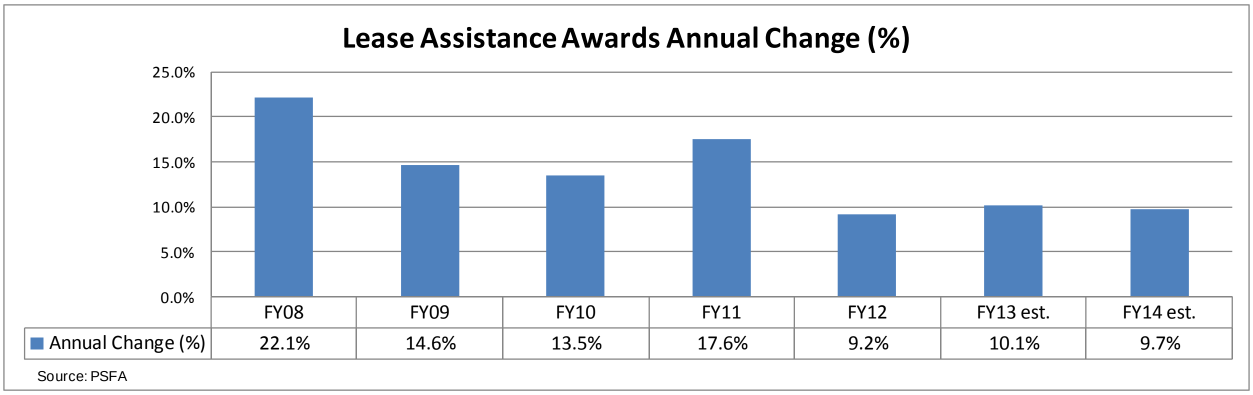
Below is a chart that lists the total amount of lease payment assistance awards by fiscal year for the last seven years:

Total Lease Assistance Awarded, FY08-FY14(est.)

FY08	FY09	FY10	FY11	FY12	FY13 est.	FY14 est.
$6,375,295	$7,306,510	$8,294,981	$9,751,689	$10,649,726	$11,726,801	$12,865,342

Source: PSFA

Lease assistance payments have been increasing steadily, although the rate of growth has slowed in recent years. The average rate of growth in lease awards can be seen in the chart below.



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 allows PSCOC to reimburse leases developed prior to execution in consultation with the council using the standardized lease format approved by the council.

LFC Staff Evaluation.

The 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 nearly doubled since FY08 and for FY14 total approximately $12.9 million in annual payments. As noted above, PSFA has developed a standardized lease; however, its use is optional, not required.

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.

Additional 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.

The full report can be read at:
http://www.nmlegis.gov/lcs/lfc/lfcdocs/perfaudit/Public%20Schools%20Facilities%20Authority.pdf

ADMINISTRATIVE IMPLICATIONS

PSFA notes there will be additional review requirements and staff analysis to provide recommendations to the PSCOC about a lease rate a comparable local market rate. A contract service provider of local real estate data may be appropriate.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Conflicts with Senate Bill 128 and House Bill 253:

SB 128 also amends sections of 22-24-4 NMSA 1978. While SB 236 adds a new section (I) on page 15, lines 22-25, SB 128 deletes language within section (H) and adds additional language to this same section. This may pose a problem if both bills are passed.

SB 236 and HB 253 both amend Section 22-8B-4.2 NMSA 1978. HB 253 as amended by the House Education Committee amends sections of 22-8B-4.2 NMSA 1978 to allow charter schools not housed in a public building to develop and follow a four-year plan to fulfill the requirements to be in a public building. SB 236 changes the same requirements by changing the language "demonstrates" to "attains" on page 8, line 5, and removes additional language on lines 6-7. The requirements of HB 253 will be slightly modified by SB 236 if both bills are enacted.

TECHNICAL ISSUES

Page 16, lines 4-8 of the bill contains the following language: "For leases, amendments and renewals entered into after July 1, 2015, these payments may reimburse leases developed prior to execution in consultation with the council using the standardized lease format approved by the council." The legislature may wish to clarify this language to ensure that the intent of this provision is clear.

OTHER SUBSTANTIVE ISSUES

The 2013 LFC staff evaluation also identified significant issues regarding potential conflict of interest. This included concerns with "Southwest Learning Centers" the collective name used for four charter schools. The evaluation found SSLC leased a facility in Albuquerque from Southwest Educational Consultants (SEC) to provide space for SSLC's Alternative Educational Program as well as additional storage space for the school. The Director was listed by the Public Regulation Commission (PRC) as the registered agent, and a director of SEC. SSLC sub-leased property from SEC; in FY11 the annual lease total was $114,000 at $13.41 PSF. The annual lease cost was $10,000 above the amount paid for the underlying master lease between SEC and the owner of the building prior to building and maintenance expenses. The Director of the SEC claims expenses totaled $2,884.00 in FY11, leaving the company with a $7,116 profit. The Director had formally disclosed this interest in SEC as a potential conflict of interest to SSLC's governing body. SSLC became the subject of an FBI investigation under conflict of interest allegations in August 2014, leading to the resignation of the Director.

ALTERNATIVES

PSFA requests additional direction regarding the term "local market rate".

While PSFA and PED note that there may difficulty in getting all charter schools into a standardized lease, given the state investment in lease assistance and to ensure proper use of state funds, the legislature may wish to make a standardized lease agreement a requirement for charter schools receiving state funds for lease assistance.

KC/je/bb/je