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

ORIGINAL DATE 2/21/2019
SPONSOR SEC **LAST UPDATED** **HB**

SHORT TITLE Charter Schools, Facilities & Capital Funds **SB** 245/SECS

ANALYST Rabin

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY19	FY20		
($20,000.0)	$0.0	Nonrecurring	General Fund Operating Reserve
$20,000.0	$0.0	Nonrecurring	Public Project Revolving Fund
($30,000.0)	$0.0	Nonrecurring	General Fund Operating Reserve
$30,000.0	$0.0	Nonrecurring	Charter Facility Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

GENERAL FUND RESERVES (dollars in thousands)

Reserve Impact		Recurring or Nonrecurring	Fund Affected
FY19	FY20		
($50,000.0)	$0.0	Nonrecurring	General Fund Operating Reserve

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
PSFA	$0.0	$0.0 - $1,882.6	$0.0 - $1,882.6	$0.0 - $3,765.3	Recurring	Public School Capital Outlay Fund
NMFA	$0.0	$20.0	$20.0	$40.0	Recurring	NMFA Operating Budget

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to SB230, SB231, SB295.

SOURCES OF INFORMATION
LFC Files

Responses Received From
Public School Facilities Authority (PSFA)
Public Education Department (PED)
New Mexico Finance Authority (NMFA)

SUMMARY

Synopsis of Bill

The Senate Education Committee Substitute for Senate Bill 245 requires school districts to make facilities not currently used for educational purposes and land not currently used or planned to be used for such purposes available for lease, lease purchase, or purchase by charter schools; the bill requires districts to notify charters of such availability and tasks PSFA with ensuring the notifications occur. SB245 also expands the facilities eligible for the Public School Capital Outlay Council's (PSCOC) lease assistance program beyond classroom facilities. The bill further amends the Public School Capital Outlay Act to create a the "charter facility fund," which will be distributed by PSCOC to pay off lease-purchase agreements. In addition, SB245 amends sections of the Public School Capital Improvements Act (commonly referred to as SB9) and the Public School Building Act (commonly referred to as HB33) to establish a process for charter schools to be included in school district resolutions under these Acts.

SB245 appropriates a total of $50 million from the general fund operating reserve to fund charter school facilities. Of the appropriations, $20 million is directed to the public project revolving fund (PPRF) to provide loans to charter schools to fund school facilities (including purchase, construction, renovation, and paying off lease-purchase agreements), and $30 million is directed to the newly created charter facility fund to pay off charter school lease-purchase agreements. Both PSCOC and NMFA are instructed to develop rules and policies regarding the distribution of these funds, including ensuring lease-purchase agreements are in compliance with the Public School Lease Purchase Act, ensuring the recipient school's charter has been renewed at least once, and reviewing the school's last two audits.

This bill also makes minor technical changes to the Public School Capital Outlay Act.

FISCAL IMPLICATIONS

The $50 million appropriation contained in this bill is a nonrecurring expense to the general fund operating reserve. Any unexpended or unencumbered balance remaining at the end of a fiscal year shall not revert to any other fund.

The LFC and executive budget recommendations target spending at levels needed to reach specific general fund reserve targets considered necessary to maintain fiscal solvency for the next fiscal downturn. The $50 million appropriation from the general fund operating reserve contained in this bill would lower the reserve level. In order to maintain the target levels, the Legislature would need to reduce general fund revenue appropriations by $50 million.

The public school capital outlay fund is the source of funding for the standards-based and systems-based capital outlay programs for public schools statewide, as well as for the state match for the Public School Capital Improvements Act (SB9), lease assistance program, facility security program, master plan assistance program, and other programs under the Public School

Capital Outlay Act. Revenues to the fund are derived from supplemental severance tax bonds and allocations from the fund are authorized by PSCOC.

SB245 makes expands the portion of school facilities eligible for funding from PSCOC's lease assistance program. In FY19, PSFA reports PSCOC awarded approximately $15.8 million to charter schools as part of the lease assistance program, covering about 66 percent of total lease costs. Expanding eligible facilities from "classroom space" (which is limited to classroom space and direct administrative space) to "facilities" (defined as "the space needed, as determined by the five year facilities master plan aligned with statewide adequacy standards, for school activities") may allow charter schools to receive funding for the entirety of their lease costs. This could increase annual lease assistance payments by up to $536.8 thousand compared to FY19 lease assistance and $1.9 million compared to projected FY20 lease assistance, decreasing the balance available in the public school capital outlay fund for other programs. This is indicated as estimated additional operating budget impacts in the tables above.

In addition, PSFA notes that in FY19, PSCOC provided lease grant assistance to 11 charter schools in lease-purchase arrangements whose outstanding balances totaled $46.8 million. PED reports about 25 charter schools have approved lease-purchase arrangements; the additional 14 schools with these agreements likely also carry significant balances. The $30 million appropriation to the charter facility fund for this purpose is insufficient to cover the costs of paying off all lease-purchase arrangements, and establishing this program may create an expectation that additional appropriations will be made in the future to completely pay down the cost of outstanding arrangements.

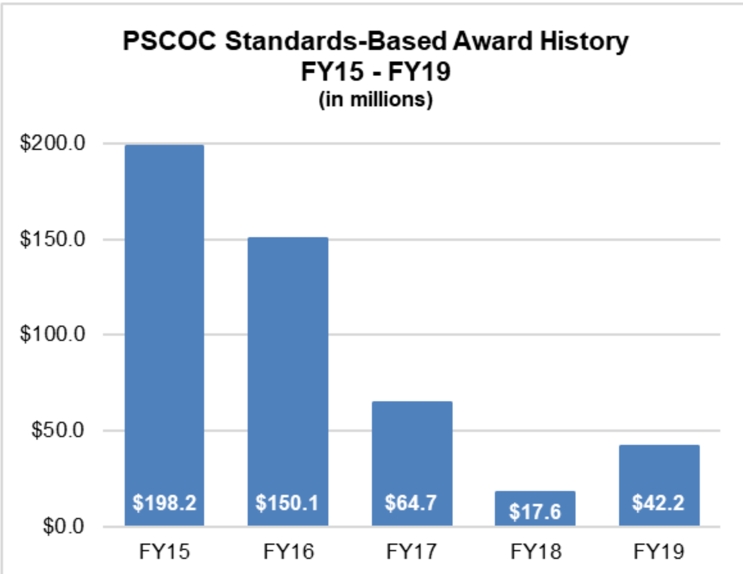
Leveraging the $30 million in the charter facility fund to pay off lease-purchase arrangements for schools currently receiving lease assistance could reduce annual costs for lease assistance by an estimated $1.4 million, which could help offset the cost of increasing eligible square footage under SB245. However, these savings are highly dependent on which schools are selected to receive funding to pay off their lease-purchase arrangements and when those pay offs occur.

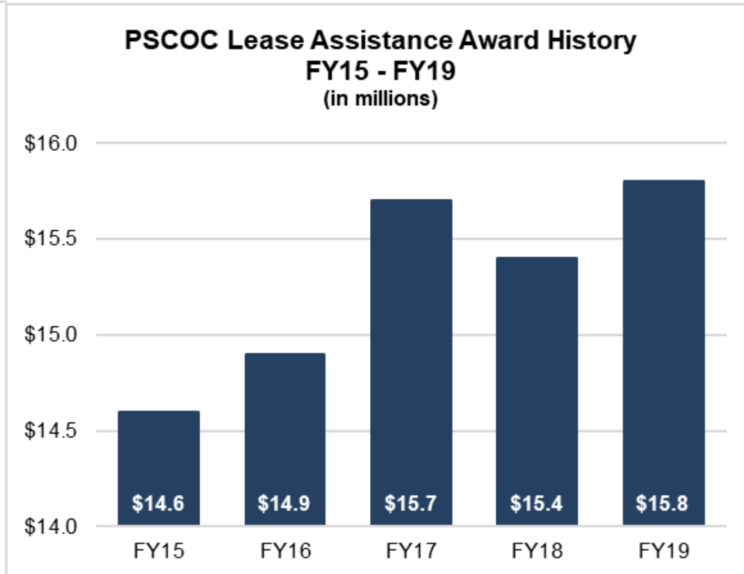
NMFA notes that because the PPRF can only fund charter schools through lease purchase agreements, and NMFA needs to hold title and own the property, the agency may require additional resources to manage a real estate portfolio of charter school facilities. NMFA states these costs will be nominal and estimates them at $20 thousand annually. This cost is included as estimated additional operating budget impacts in the tables above.

SIGNIFICANT ISSUES

PED notes that PSCOC's current standards-based funding program was developed and established in response to the *Zuni Public School District vs. State of New Mexico* lawsuit, which found that the New Mexico Constitution's guarantee of "a uniform system of free public schools sufficient for the education of, and open to, all children of school age" applies to capital funding. As a result, PSCOC was established to ensure sufficient and equitable capital funding for all New Mexico schools. While school facility conditions have improved since the council was established, the lawsuit remains open, and as such PED states it is essential to fully fund the standards-based and systems-based award programs to fulfill PSCOC's core mission of ensuring educational adequacy. PSFA expresses concerns that the lease assistance program creates a competing interest with funds available to make awards that support its core mission of addressing the inequities identified in the *Zuni* lawsuit.

In recent years, PSFA reports standards-based awards have decreased while lease assistance awards have historically tended to increase year-over-year. The following charts reflect the total lease assistance and standards-based awards between FY15 and FY19:





While SB245 requires charter schools be notified of available land or facilities, there is no requirement that charters accept and use it. Further, PSFA notes there is no indication that the facilities offered must meet the educational program of the charter or the requirements of the Charter Schools Act regarding charter school facility standards. PED adds that requiring districts to make land or facilities available to charter schools located within their district may pose legal concerns as it might require districts offer land or facilities to state-authorized charters, which are separate local education agencies not associated with the district. Additionally, the bill does not impose any requirements regarding the purchase price of available facilities or land.

PSFA further adds that this bill does not specify who may be a titleholder to the property once payment of a lease-purchase arrangement is complete, nor does the bill include language indicating what will become of the property in the event of the school's closure. Because charter schools often enter lease-purchase arrangements through their private foundations, failing to specify these items could result in a building purchased with state funds being owned by a private entity (the foundation). PSFA raises the concern that this could violate the New Mexico Constitution's anti-donation clause. Senate Bill 624 could resolve this issue by requiring foundations to transfer a facility's title to the charter school.

ADMINISTRATIVE IMPLICATIONS

PSCOC and PSFA will need to develop guidelines and a process to allocate funds from the charter facility fund, which may include an application and ranking methodology.

PSFA indicates it currently collects the information necessary to ensure charters are notified of unused facilities.

According to NMFA, providing loans to charter schools through the PPRF may impose additional operating costs (detailed in Fiscal Implications, above).

RELATIONSHIP

This bill relates to Senate Bill 624, which requires charter schools in a lease arrangement with a nonprofit foundation organized for the purpose of providing a facility for the school to have an agreement in place to transfer the title from the foundation to the school as soon as the title is acquired. The bill also requires schools in this arrangement demonstrate that such an agreement is in place as a condition of receiving lease assistance.

This bill relates to Senate Bill 230, Senate Bill 231, and Senate Bill 295, which also amend the Public School Capital Outlay Act.

TECHNICAL ISSUES

PED notes that it may be desirable to insert the word "geographically" or "physically" into Section 1, subsection F, so the language reads as follows:

> "A school district that has available land or one or more available facilities not currently used for other educational purposes shall make the land and facilities available for lease, lease-purchase or purchase to the charter schools [physically] located in the school district for their operations and shall notify them of that availability no later than May 1st of each year."

A locally-authorized charter school is both physically located in the school district and is also a part of the district. A state-authorized charter school can be physically located in the same geographic location as a school district, but is considered independent and not a part of the school district.

SB245 provides that the amount of lease assistance given to a district or charter school shall not exceed either "the actual annual lease payments owed for leasing a facility; or seven hundred dollars ($700) multiplied by the MEM using the leased facilities" (page 11, lines 17 to 23). While "facilities" is defined, "a facility" is not defined, and may be interpreted as more restrictive than the definition of "facilities." For example, it could be determined to only refer to a building but not surrounding land. This could be resolved by amending lines 19 to 21 to read "the actual annual lease payments owed for leasing facilities.

SB245 references "five-year facilities master plan" on page 13, lines 20 to 21, in its definition of "facilities," which determines what facilities may be eligible for lease assistance; however, Subsection K references "five-year facilities plans" (without the word "master") on page 14, line 22. This language should be consistent.

PSFA reports four charter schools received $541 thousand in lease assistance in FY19 for land leases; however, neither the definition of "classroom facilities" nor the proposed definition of "facilities" in SB245 explicitly include land. If this bill is enacted, this definition could potentially be interpreted to either encompass the full cost of land leases or exclude land leases from lease assistance.

SB245 states that the newly created charter facility fund "shall be used to pay off charter school lease-purchase agreements," but instructs PSCOC to "adopt rules to provide loans to charter schools for the purchase, construction, expansion, or renovation of facilities" (page 18, lines 4 to

8). This fails to include policies related to paying off lease-purchase agreements, which should be included. In addition, the introduced version of this bill restricted use of this fund to paying off lease-purchase agreements and did not suggest loans would be provided from the fund, and this was not presented as an intentional substantive change in committee, suggesting it may be unintentional. If so, the issue could be resolved by amending the language in lines 6 to 8 to read "The council shall adopt rules to pay off lease purchase agreements that include…"

PED notes the bill does not contain an effective date, but it may be desirable to include one because deadlines established within the bill (May 1 and June 1) may otherwise pass prior to the bill taking effect.

OTHER SUBSTANTIVE ISSUES

PSFA notes the bill does not indicate a prioritization methodology to determine how expenditure of the charter school facility fund will be authorized. Laws 2007, Chapter 214, (Senate Bill 634) created a charter school capital outlay fund, the balances of which were intended to assist state-chartered charter schools with the local match needed for an approved public school project. Awards made to state-chartered charter schools for capital projects were made using the same standards-based prioritization method as other traditional public schools. According to PSFA, it is important to note that the underlying premise behind standards-based funding has been to prioritize awards based on facility condition.

NMFA states the PPRF is authorized to provide loan financing to charter schools for school facilities through lease-purchase arrangements, with NMFA taking on the role of titleholder and property owner of the facility. To date, the PPRF has made only one lease-purchase financing agreement directly for a charter school facility. Current PPRF loan management policies require charter schools to meet either a 75 percent loan-to-value ratio or an 80 percent loan-to-value ratio if the overseeing school district of a locally chartered charter school is involved in the lease purchase arrangement. According to NMFA, charter schools have found it challenging to meet the minimum loan-to-value ratios. The loan-to-value ratios were developed so charter schools have an equitable interest at stake, as well as to help mitigate the 'walk-away' risk that is inherent with lease purchase agreements.

NMFA explains the $20 million appropriation to the PPRF included in this bill would be held in a restricted charter school guarantee account within the PPRF subordinate lien so that it may be used as a guarantee fund to buy back any non-performing charter school facility lease purchase arrangements that the PPRF makes. The agency notes this appropriation would help mitigate the financial risks of a non-performing charter school. NMFA states it is possible the agency could consider revisions to the loan-to-value ratios given the reduced risk.

NMFA staff estimates the $20 million restricted charter school guarantee account appropriation could be leveraged approximately three to four times, meaning the PPRF could support approximately $60 million to $80 million outstanding charter school facility financings at any given time.

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