FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	HGEIC	**ORIGINAL DATE**	3/3/23
SHORT TITLE	School Board Governance Requirements	**BILL NUMBER**	CS/House Bill 143/ HGEICS
		ANALYST	Liu

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
		($4,804.3) - $0.0	($4,804.3) - $0.0	($9,608.6) - $0.0	Recurring	Charter School Budgets
Total						

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent analysis of this legislation.

Relates to HB375, SB422, SB466

Sources of Information

LFC Files

Responses Received From
Public School Facilities Authority (PSFA)
State Auditor (OSA)

No Response Received
Public Education Department (PED)

SUMMARY

Synopsis of HGEIC Substitute for House Bill 143

The House Government, Elections and Indian Affairs Committee substitute for House Bill 143 amends the Public School Code, prohibiting charter school lease assistance from being used for operational expenditures, requiring new charter school facility educational conditions to be at least as good as the statewide average, allowing the Public School Capital Outlay Council (PSCOC) to set lease payments at a local market rate, requiring charter school governing body members and employees to disclose conflict of interest statements, voiding contracts if a conflict of interest exists, and requiring charter school authorizers to review conflict of interest disclosures and report them to PED annually.

FISCAL IMPLICATIONS

The bill does not contain an appropriation but may reduce costs of charter school lease assistance. Provisions of this bill authorize PSCOC to adjust lease assistance funding for charter schools that are leasing from school districts at the local market rate, which could be lower than current lease award amounts. Additionally, the bill requires PSCOC and the charter school authorizer to review charter school leases, amendments, and renewals entered into after July 1, 2023, to ensure lease assistance payments are not used for operational expenditures. This limitation may reduce costs to charter school leases that include payments for other expenditures beyond lease costs.

In accordance with state law, PSFA determines charter school lease assistance payments based on the lesser of two calculations:

- Student membership (MEM) multiplied by a flat rate ($815.60 in FY23), or
- Actual lease costs.

A 2022 LFC evaluation on state facility utilization found the average cost of state-owned space was $5 per square foot and the average cost of leased space was $19 per square foot. In FY22, charter schools spent $27.9 million on lease payments and received $18 million from the Public School Facility Authority (PSFA) for lease assistance on eligible facility spaces. On average, charter schools paid $14.56 per square foot for eligible classroom facility space; however, 38 charter schools paid more than $19 per square foot of eligible classroom space. The amount in excess of $19 per square foot at these 38 charter schools totaled $4.8 million. The fiscal impact assumes these lease payments that exceed state facility lease rates may include operational expenditures and could present potential cost savings to charter school operating budgets.

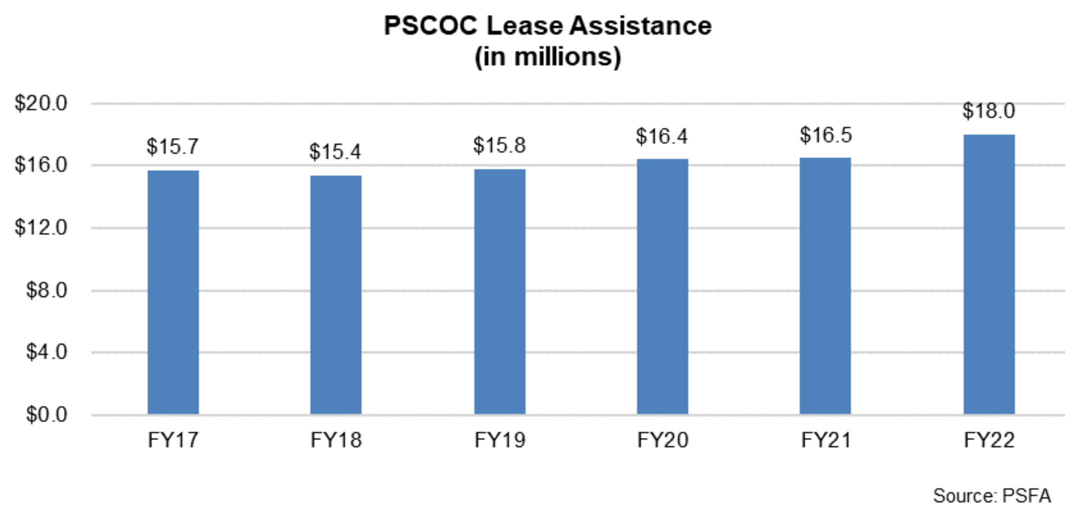
SIGNIFICANT ISSUES

Provisions of this bill allow PSCOC to approve charter school lease payments at the local market rate, require charter schools to locate in a facility that will attain—rather than plan to demonstrate—a weighted New Mexico condition index (wNMCI) score better than the statewide average (currently 24.2 percent) prior to occupancy, require individuals serving as a charter school employee or board member to disclose conflicts of interest, require charter authorizers to review, report to PED, and approve conflict of interest disclosures, and prohibit the use of charter school lease assistance for operational expenditures, including property taxes, utilities, custodial fees, insurance, or repairs.

A 2013 LFC evaluation on PSFA charter school facilities noted significant issues with charter school facility leases and recommended requiring PSCOC to develop and use a standardized lease format and to use lease assistance only for base lease amounts, prohibiting the inclusion of any other costs. The evaluation found 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 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 PSCOC. In addition, charters pay for school foundation fees and expenses, and school foundation reserves, which require further scrutiny from the schools' authorizer.



In 2022, the State Auditor (OSA) completed a special audit of the GREAT Academy, a state-chartered charter school in Albuquerque, which found the school funneled dollars through its foundation to provide additional contracts and bonuses to the school's husband-and-wife founders. Between FY17 and FY22, the school's foundation, which owns the school building, received about $2.3 million from the charter school for lease payments. The foundation spent $1 million on the building mortgage and maintenance, $757 thousand on professional services and school support, and $138.7 thousand on travel and operational expenses. About $228 thousand of the foundation's professional services payments went to the school's two founders in the form of consulting contracts and bonuses. The two founders are also school administrators already on the charter school's payroll, meaning the couple received double compensation.

For FY23, PSFA reports 29 charter school facilities leased from public entities, with 25 facilities receiving lease assistance awards from PSCOC based on student membership counts.

ADMINISTRATIVE IMPLICATIONS

Provisions of this bill would increase oversight in PSFA's approval process related to new or relocated charter school facilities. Provisions of this bill would require charter schools to locate in relatively new or large facilities to meet the statewide average wNMCI score of 24.2 percent; however, identifying facilities with good building conditions would reduce annual maintenance and repair costs for charter schools. PSFA notes provisions of this bill do not provide guidance on the consequences or procedures if the charter school does not attain the required wNMCI score, making the requirement unenforceable. Only two charter schools have attempted to meet the 18-month provision currently in statute. PSFA notes neither school was able to complete the upgrades necessary to meet the wNMCI requirement within 18 months and requested extensions.

PSFA notes most PSCOC lease assistance awards are based on a student membership formula. In FY23, 12 of the leases between school districts and charter schools have lease agreements stating the annual lease amounts are based on the PSCOC lease assistance award. This is the most practiced approach. Only one district-owned facility does not have this language and has a specified lease amount below the potential award amount based on MEM; therefore, it receives lease assistance for the full amount of its annual lease. A few other publicly owned facilities follow the same practice, including pueblos and counties.

As such, the requirement for PSCOC to approve lease amounts at the local market rate might not be applicable in these instances. The process would add an extra tier of review by PSFA to an already laborious process because PSCOC receives over 100 lease assistance applications per year. PSFA notes determining a local market rate would be nearly impossible because there are too many variables in a local market rate comparison to adequately determine the reasonableness of the lease amount. Such factors include the location, age, condition, size, and other unique features used in the assessment of property lease values.

RELATIONSHIP

This bill relates to House Bill 375, which requires charter school authorizers to report oversight expenditures; Senate Bill 422, which limits charter school expansions; and Senate Bill 466, which requires charter school audits to be conducted separately from the charter school authorizer audit.

OTHER SUBSTANTIVE ISSUES

PSFA notes the bill would require only the reimbursement of base rent. PSFA's lease assistance application requires the applicant to exclude any operational or improvement costs to the lease amount in its application. PSFA staff reviews each lease to ensure that only the fixed rental fee (base rent) for the use of the premises is eligible for lease assistance.

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