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

September 3, 2014
Room 307, State Capitol
Santa Fe, NM

The forty-eighth meeting of the Public School Capital Outlay Oversight Task Force (PSCOOTF) was called to order by Representative Mimi Stewart, chair, on September 3, 2014 at 9:20 a.m. in Room 307 of the State Capitol.

Present
Rep. Mimi Stewart, Chair
Rep. Eliseo Lee Alcon
Tom Clifford
Dr. Carl Foster
Cecilia Grimes
Kirk Hartom
Tracy Hoffman
Rep. Larry A. Larrañaga
Rep. James Roger Madalena
T.J. Parks
Sen. Sander Rue
Sen. Benny Shendo, Jr.
Rep. James E. Smith
Allan Tapia
Rep. Jim R. Trujillo,
Designee for Rep. W. Ken Martinez
Rep. Luciano "Lucky" Varela,
Designee for Rep. Henry Kiki Saavedra

Absent
Sen. John M. Sapien, Vice Chair
Paul Aguilar
Dr. Lisa Grover
Leonard Haskie
Sen. Mary Kay Papen
Mike Phipps
Sen. Cliff R. Pirtle
Judy Rabon
Sen. John Arthur Smith

Advisory Members
Rep. Sharon Clahchischilliage
Rep. Sandra D. Jeff
Sen. John C. Ryan

Rep. Roberto "Bobby" J. Gonzales
Sen. Howie C. Morales
Rep. Patricia Roybal Caballero
Sen. William E. Sharer
Sen. William P. Soules
Sen. Pat Woods

Staff
Raúl E. Burciaga, Director, Legislative Council Service (LCS)
Sharon S. Ball, Senior Researcher, LCS

Kathleen Dexter, Researcher, LCS
Michelle Jaschke, Researcher, LCS

Guests

The guest list is in the meeting file.

Handouts

Copies of all handouts are in the meeting file.

Wednesday, September 3

Welcome and Introductions

The chair welcomed members and guests and called the meeting to order.

Approval of August 1, 2014 Meeting Minutes

On a motion duly made and seconded, the minutes of the August 1, 2014 meeting were approved without objection.

Public School Capital Outlay Funding Stream: Report on the Severance Tax Permanent Fund and Issuance of Supplemental Severance Tax Bonds

Steven K. Moise, state investment officer, Investment Office, provided an overview of returns from the Severance Tax Permanent Fund (STPF), observing that relatively high interest rates for bonds had lent stability to the portfolios early in the new century. He noted that, now that bond return rates have fallen below three percent, they afford little protection from volatility in the stock market. Current projections forecast a stock return rate of around seven percent, down by about five points from previous return rates. Mr. Moise reported that the State Investment Council (SIC) has successfully compensated for volatility in the markets by diversifying the state's portfolio to include private equity and hedge funds as well as real estate investments.

The SIC goes through an in-depth asset reallocation study every three years, according to Mr. Moise, and provides a management tool that has given the SIC a competitive investing edge. He further noted that there is a huge change in the types of revenue passing through the fund, and bond investments that formerly contributed as much as 50 percent to the fund's income now account for only around five percent of that income. The STPF will provide $10 million less this year to the general fund because the fund still has not recovered from the major economic upheaval that began in 2008.

Vince Smith, deputy state investment officer, reviewed the impact of contributions and distributions on the permanent funds. He reported a record high close for fiscal year (FY) 2014 of over $19 billion with a total assets investment return of 15.9 percent. He said that combined distributions from the Land Grant Permanent Funds (LGPF) and the STPF for FY 2015 total $778.7 million. Mr. Smith projected that FY 2016 distributions from the funds will increase by around $65 million, and he emphasized the importance of growing the corpus of each of the funds.

Mr. Smith reported that assets have grown by about $6 billion as a result of improved management of the funds, a stronger market and a more engaged and restructured council. The new council has diversified investments to improve returns and limit risks, and the fund returns are climbing. The LGPF have totally recovered from the steep market decline of 2008, while the STPF has almost returned to its 2007 value. Mr. Smith further detailed a recent steep increase in inflow to the STPF following years of inconsistent contributions, a result of increased oil and gas production in the state.

Peter van Moorsel, chief economist, Legislative Finance Committee (LFC), presented information on the August 2014 estimate of severance tax bonding capacity, including an overview of how that capacity is estimated from taxes derived from severing natural resources from the land and the types of severance taxes-backed debt offerings the state generally employs. Mr. van Moorsel provided a breakdown of capital outlay funding that will be available based upon the bonding forecast for the Water Project Fund, Tribal Infrastructure Project Fund, the Colonias Infrastructure Project Fund and the legislature's capital outlay projects. In addition, Mr. van Moorsel presented graphic information demonstrating the correspondence of greatly improved school facilities conditions with the expenditure of Public School Capital Outlay Council (PSCOC) awards since the beginning of the twenty-first century. The PSCOC reported awards of over $256 million in FY 2013, an increase of over $100 million from FY 2012.

Task force members and the panel discussed proposed legislation to phase in changes to STPF inflows, distributions and investment strategies. Task force members agreed that, ideally, such legislation would not single out any one of the current beneficiaries of the STPF distributions for funding cutbacks. Such legislation might also include provisions to enable the SIC to utilize other investment categories for the STPF, such as international equity funds that might encompass greater risks but could provide increased returns on investment.

Members discussed various means to grow the corpus of the STPF without reducing distributions, including increased taxation for oil and gas production. Discussion ensued regarding the percentage of current funding that would have to be cut back if a reduction in distributions is used to expand the corpus of the fund. One member reported that he had previously sponsored legislation to take money out of the LGPF to support early childhood education. This member asserted that solving public education problems now will result in benefits ranging from better jobs to improved behavioral health, saving money in the long run. Mr. Moise reported that draft legislation has not yet been completed, but he agreed with task force members that it is important to bring draft legislation forward soon to begin to address issues that have stymied the passage of previously proposed legislation.

State Auditor's Risk Review: Ways to Increase Accountability over Public School Capital Outlay Act Education Funds

Evan Blackstone, Esq., chief of staff, Office of the State Auditor (OSA), reported on findings from a comprehensive risk review of four Albuquerque-area charter schools that resulted in referrals to the Federal Bureau of Investigation (FBI) and subsequent FBI raids on those institutions. The focus of the OSA review fell on two of the state-chartered charter schools in question, Southwest Secondary Learning Center (SSLC) and Southwest Aeronautics, Mathematics and Science Academy (SAMS), and the schools' leases of aircraft and property from Southwest Educational Consultants, Inc. (SEC), also doing business as Diamond Aviation, a business co-owned by an instructor for the SSLC and Dr. Scott Glasrud, head administrator for all four charter schools. Mr. Blackstone noted that the significant amount of public funds paid by SSLC and SAMS to SEC/Diamond Aviation over numerous fiscal years, in addition to the conflict-of-interest concerns inherent to this business relationship, prompted the risk review.

Mr. Blackstone outlined numerous risks, internal control deficiencies and potential violations of law revealed by the OSA review, including the direct conflict of interest between Dr. Glasrud's personal financial interest in Diamond Aviation and his broad and influential authority as head administrator for the schools. The review found serious deficiencies in the procurement processes that the schools employed, possible manipulation of those processes and apparent subversion of the stated purposes of the Procurement Code. Mr. Blackstone noted that the FBI raids and intervening investigation have superseded the OSA's final investigation results.

Mr. Blackstone noted that the OSA strongly recommends that state authorities review and take appropriate oversight actions to safeguard funds. The Public Education Department (PED) last week suspended the boards for those schools and is attending governing council meetings to ensure communication with appropriate state and local agencies and auditors. David Abbey, director of the LFC and chair of the PSCOC, noted that it is important to understand that Public School Facilities Authority (PSFA) funds were not misused in this instance and that the PSFA has talked about next steps with state agencies and the governing councils to ensure accountability.

Due to the ongoing investigation by the FBI, Mr. Blackstone was not able to address members' questions regarding the FBI's involvement and possible indictments in the case. Members discussed how a standardized lease agreement might present both problems and solutions in the case of charter schools and outliers and reviewed provisions of the conflict-of-interest questionnaire and how that process might be strengthened. Joe Guillen, chair, Awards Committee, PSCOC, noted that one problem for charter schools in preventing conflicts of interest is the way that governing council members and school board members are recruited. Frequently, there is little oversight by members who have been recruited by school personnel. In addition, few requirements exist to spread the responsibility for conflict-of-interest certifications to governing council members or school board members. Mr. Guillen also affirmed that the PSFA has no current requirement to investigate the veracity of conflict-of-interest certifications.

Robert Gorrell, director, PSFA, noted that the charter schools under review by the OSA had received lease assistance from the PSCOC but not for any of the items questioned in the OSA review. The chair noted that there are currently 98 charter schools and some 800 public schools and concurred with other task force members that personnel and financial resources are insufficient to address the magnitude of the oversight task. Mr. Blackstone agreed that resources are critical to successful oversight but noted that some of the oversight problems are a result of the way the laws are structured. The OSA review pointed out a number of loopholes that were exploited. Task force members suggested that oversight agencies take note of audit findings that expose poor segregation of duties, potential conflicts of interest and procurement questions and then follow up quickly on such findings. In response to task force discussion and questions, it was later noted that audit findings are public once they have been released and that in some instances a finding will trigger notification of an oversight agency.

Mr. Guillen noted that more and more charter schools are seeking training for governing body members to let those members know the extent of their responsibilities as governing body members. He pointed out that because school board members are elected, and charter school governing council members are not elected, the community may not know whom to turn to when questions arise. The chair suggested that all charter schools be required to post information on web sites regarding governing councils, school founders, mission statements and other pertinent information and that such a requirement be included in legislation. One member noted that there was no evidence to suggest that PSCOC funds were actually misused and perhaps the task force should focus on standardized lease documents and investigating conflict-of-interest statements.

Discussion ensued regarding national performance frameworks for charter schools and what effect the suspension of the charter for SAMS would have on students. Mr. Blackstone reported that only 10 to 15 students are enrolled in the flight program at SAMS, that students do not graduate from the SAMS program with a pilot's license and that reports that they will be denied a license due to the suspension are inaccurate.

Visitors from over a dozen southwestern, Pacific and northwestern states who were attending a state fiscal directors conference hosted by New Mexico visited the task force meeting room and were welcomed by the chair and task force members.

Charter Schools and the Statutory Deadline to Occupy Public Buildings

Jeff Eaton, director, PSFA Business Operations, presented a spreadsheet showing charter school district affiliation and grade level, gross square footage, numbers of students and square feet per student, as well as information on facilities conditions and asset ownership. Much of the space utilized by charter schools is leased, and the schools receive lease assistance from the Public School Capital Outlay Fund. Mr. Eaton stated that the PSCOC has developed a standardized lease, although the instrument has yet to see much use. Mr. Gorrell outlined some of the obstacles that the PSCOC has encountered in getting charter schools on board with the standardized lease program, but he noted that the PSCOC does have the authority to require use of the standardized lease form.

The PSCOC is working to roll out use of the standardized lease agreement incrementally, starting with an information collection process. Mr. Gorrell stated that there is great value in having a standardized lease agreement that includes all of the PSCOC requirements in order to minimize costly review processes and noted that addenda to the standardized agreements can be used to clarify special conditions for outliers and charter schools.

Task force members discussed the possibility of conflicts of interests arising in lease-purchase agreements for school facilities. Mr. Abbey stated that conflict-of-interest disclosures should address that issue. Mr. Gorrell endorsed the idea of having all charter school board members sign off on the disclosures.

Further discussion addressed the relative merits of leasing public space as compared to privately owned space. Mr. Eaton explained that the intent of the charter schools legislation relative to the use of public facilities is to minimize costs and to alleviate constitutional concerns regarding antidonation issues. Some members suggested that public space is not necessarily less expensive than private space and that the quality and condition of the facility should be of primary concern.

Mr. Gorrell presented information comparing charter school lease costs per square foot with average market values of office space in the Albuquerque area. The analysis revealed that many charter schools appear to be "getting a helping hand" from the community with lower than average costs per square foot. Mr. Gorrell asserted that many lessors need help in understanding that maintenance costs are generally equal to the basic square footage cost of a lease. Operating costs may be much more than the basic value of the lease agreement, and that needs to be factored into a school's budget.

Mr. Eaton and Mr. Gorrell explained that the PSCOC supplemental severance tax bond fund balance now approaches $0.5 billion because it includes new awards and a committed but unexpended balance for projects that are in process or under construction, as well as an uncommitted balance. The fund balance is large but not excessive given the average award amount and monthly expenditure activity.

The chair related that much thought has been given to the impending statutory deadline for charter schools to move into public facilities; however, the legislature has not yet come up with a solution that is agreeable to all of those who are affected. The rising cost of public school funds going to private owners leasing facilities to charter schools prompted the legislature in 2005 to create a 2010 deadline for charter schools to be located in public facilities. As the 2010 deadline approached, only a small percentage of charter schools had met the requirement, and the deadline was extended to 2015. The chair noted that the statute appears to be unworkable, as many schools will still not be in compliance in 2015. Further, the burgeoning population of charter schools was not anticipated when the statute was put into effect. The question arose of how to create incentives for both the public schools and charter schools to better utilize existing facilities.

Mr. Abbey explained that the current role of the PSCOC is to administer legislation and ensure effective and appropriate use of facilities. Mr. Gorrell directed task force members' attention to the issues paper prepared by the PSFA regarding charter schools. He pointed out that the paper identifies several problems related to charter school development, including a dearth of planning expertise for charter school facilities needs, the lack of an administrative procedure to encourage charter schools to use the available space that must statutorily be offered to them by the school districts and the need for a standardized lease with a mechanism to meet the facilities needs of charter schools' special curricula.

Task force members expressed frustration with the process, suggesting that a mandate should exist for charter and magnet schools to use existing district space regardless of the chartering authority. Mr. Abbey suggested that a statutory change to allow the PSCOC to arbitrate disputes might be of value. Mr. Gorrell asserted that charter schools are not rejecting district space as unsuitable because all of the facilities offered must be in above-average condition. He further noted that lease assistance for these schools is included in statute. While lease assistance starts at $700 per student, Mr. Gorrell reminded the task force that the actual cost to operate the facility may be twice that amount if maintenance costs are included. He stated that the PSCOC is already looking at school district master plans to try to encourage effective use of building inventory.

The chair stated that clearly the wrong incentives are being applied if fewer than one-half of the charter schools will be in compliance with the public buildings requirement by the 2015 deadline. It was noted that some schools likely are ignoring the deadline for lack of enforcement and that there is no reward for compliance. While it was agreed that schools should be required to live up to their commitments, it was also argued that student well-being is the primary issue. Panel members suggested that fortifying the statute to steer charter schools into existing space that is maintained by a school district may be the best option.

Discussion ensued regarding the Facilities Condition Index (FCI) included on the charter school spreadsheet. The chair observed that some of the leased charter school facilities have a very high (bad) FCI. Mr. Gorrell emphasized that the PSCOC focuses its improvement efforts on those facilities with a high FCI and remarked that the PSCOC can pursue legal action against a local school district that fails to seek needed school bond funding. He pointed out that the recalcitrant district option of the law has never been invoked and that the PSCOC has chosen to work around such issues with the local school districts.

Prorated Proceeds from Education Technology Notes for Charter Schools

Paul Cassidy, managing director, Royal Bank of Canada Capital Markets, U.S. Public Finance Division, discussed education technology notes (ETNs) and the history of New Mexico's Education Technology Equipment Act with the task force members. He explained that ETNs may be used when a school district enters into a lease-purchase arrangement to acquire education technology equipment. Mr. Cassidy presented examples of ETN transactions and the widely varying costs of such transactions, especially as they relate to bond ratings of the school districts.

In the small school district of Vaughn, an ETN issuance of $100,000 bore a true interest cost of around seven percent, while an $11 million issuance in Santa Fe carried a true interest cost of less than one percent.

Mr. Cassidy explained that general obligation ETNs do not require voter approval; however, a public hearing process is required. ETNs may be sold or issued at public competitive sale, negotiated sale or private sale to the New Mexico Finance Authority (NMFA) or the Office of the State Treasurer. Mr. Cassidy reported that the notes provide a sustainable, predictable and equitable source for funding technology needs. Further, he asserted, technology and technology maintenance costs could be permanently shifted to an ETN program. Mr. Cassidy also recommended enabling legislation for staff support for technology projects, as well as a state guarantee for ETN issuances.

Art Melendres, Esq., legal counsel, Albuquerque Public Schools, pointed out the importance of improving bond ratings for smaller districts in order to lower costs. Task force members and the panel discussed provisions in proposed legislation to enable charter schools to receive a prorated share of funding from ETNs. Some task force members continue to object to state-chartered charter schools sharing in district technology funding. Mr. Cassidy observed that there should be a direct funding mechanism for state-chartered charter school technology needs, but resource limitations likely will preclude that possibility.

Members debated whether to include provisions in the proposed legislation to allow some of the proceeds to be used to purchase the services of training and technology specialists and software or cloud storage licenses. A question arose regarding whether or not using property tax levies to fund such items through ETNs blurs the lines of appropriate public school capital expenses. Further discussion addressed the importance of distinguishing between taxable and nontaxable bonds and what can be legally funded under those bonds in any proposed legislation.

Mr. Melendres affirmed that the draft of the proposed legislation includes a state guarantee of the bonding mechanism. The equalization formula entered into the discussion as members debated how the use of any funds generated from ETNs will be prioritized. Mr. Melendres acknowledged that ETNs are a tool to get technology funds if the voters turn down other means and that direct funding of such needs would be a more equitable and less expensive option.

Discussion of Possible Legislation for PSCOOTF Endorsement and Direction to Staff

The chair expressed concern that previously proposed legislation, in its form as proposed in the 2014 legislature, is perhaps unworkable because of changing the use of ETNs to mandate charter school sharing and including proposals to fund staff, support, licensing and other items. Charter schools are not currently included in statute to receive technology funding; however, the chair noted that a district may elect to share such funding with charter schools. The chair presented a short list of items to discuss to give direction to bill drafting:

- a building systems bill — a proposal to allow schools to use a portion of their funding to address FCI issues and try to expand the life of their buildings;
- a standardized lease agreement;
- extension of the deadline for charter schools to locate in public buildings;
- *Zuni* lawsuit litigant legislative concerns;
- development of improved maintenance cost codes for use and reporting by the Public Education Department and PSFA; and
- broadband service assessment and possible expansion.

Discussion surrounding these issues revealed that the *Zuni* lawsuit litigants had mentioned the building systems bill as one mechanism to prevent reintroduction of the *Zuni* lawsuit. One member characterized the bill as a means to find new uses for public school capital outlay funding that is no longer needed and said that local school districts should fund maintenance costs. The chair asserted that waiting to tear the buildings down rather than maintaining them is a waste of money and that the intent of the bill is to use the funding more effectively.

Another member noted that part of the bill provides for a recalculation of district square footage needs, addressing school district concerns about local share maintenance costs. Mr. Gorrell advised the task force that the provision was intended to allow schools to be proactive in reducing facility size, thereby increasing the funds available for local operating expenses. Ms. Ball noted that the bill is a deficiency-correction program modeled after the roofing deficiency bill that has been highly successful over a five-year period in helping districts to meet code compliance issues. Mr. Gorrell and Ms. Ball affirmed that a building systems definition is in place and that percentage limitations for certain categories of expenditures are included. Another task force member indicated that the executive branch seems to concur with the need for the building systems bill.

Mr. Gorrell reinforced the importance of knowing at least four years in advance the timing for any major funding changes. With approximately $120 million to $140 million in process at any time for planning and construction, projects are at risk of being abruptly cut off or underfunded if money is unexpectedly moved. A request was made to bring the PSFA budget to the task force for review.

The chair suggested the possibility that the task force should recommend going back into statute and requiring the agreement by charter schools. Mr. Gorrell explained the time and cost-saving advantages to using a two-part lease wherein the standard and variable items are separated. He noted that this approach increases accountability and provides multiple benefits to the charter schools. Members also suggested adding language to the statute to help settle disputes between state-chartered and locally chartered charter schools and to extend the relocation deadline for two years.

One member suggested that establishing a new deadline is moot. Mr. Gorrell noted that public space does not equate to school facilities and that perhaps the task force should define more clearly what is expected of the charter schools and give the PSCOC more power to achieve that end. He further related that the PSFA had already been given direction to modify lease agreements to solicit more information on costs per square foot. Members also discussed lease-purchase agreements. It was noted that only one such lease-purchase agreement has come forward to the NMFA and that the NMFA is still evaluating its efficacy. It was reported that seven schools have lease-purchase agreements in effect.

Mr. Gorrell asserted that a big point for the PSFA in assessing lease agreements and school needs is understanding what is being spent, especially for maintenance. The current cost codes do not provide a sufficient level of detail to enable good management. He stated that although the PSFA now has a measure of maintenance effectiveness, the inaccuracy of current cost codes prevents effective targeting of funding. Further, effective cost codes could be easily developed and reported. Mr. Gorrell reminded the task force that enabling legislation for assessment and possible expansion of broadband service for schools throughout the state is pending.

Task force members discussed the need to revisit the equalization formula generally and for the purpose of addressing the current concerns of the litigant districts in the *Zuni* lawsuit. Mr. Gorrell advised the task force that the PSCOC will be hearing more from the Gallup-McKinley County School District and that other areas, such as Carlsbad and Hobbs, where property taxes have skyrocketed, have related concerns about local matching fund requirements. The *Zuni* litigants have agreed to stipulate to the judge that they will search for legislative solutions, but the issue may go to court anyway.

Mr. Moise was directed to work with the other parties at the meeting to develop draft legislation to be presented to the task force as soon as possible. The chair informed the members that the October meeting may be held at the Santa Fe Indian School.

With no further business before the task force, the meeting was adjourned at 3:15 p.m.