

BILL ANALYSIS

Senate Research Center
85R12752 MEW-F

S.B. 1658
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Education
3/31/2017
As Filed

AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

S.B. 2, passed during the 83rd Legislative Session, required the Texas Education Agency (TEA) to close a charter school if it is assigned an unacceptable academic and/or financial rating for three consecutive years. After S.B. 2, approximately 26 charters have been closed. This amount exceeds the total number of closures within the past 10 years combined and has brought to light the lack of process in the disposition of assets purchased with state funds upon the cessation of operations of a charter school.

One of the Senate Committee on Education's interim charges was to study this issue and develop legislative recommendations for addressing this problem. S.B. 1658 is a result of intensive stakeholder discussions since the committee's interim hearing in December 2015. The committee sought input from the TEA, the General Land Office, the Texas Charter School Association, Texans for Quality Public Charter Schools, the Texas League of Community Charter Schools, bond attorneys, and charter school operators during this process. S.B. 1658 will reduce litigation related to charter school closures, encourage greater transparency in charter school real estate transactions, and provide TEA clear and helpful guidance on disposing of the property of a charter that ceases to operate.

- SB 1658 provides guidance to the state on how to dispose of a charter holder's property purchased with state funds.
- The bill language authorizes TEA to direct the charter holder upon closure to dispose of the property through one of the following methods:
 - Retain property and reimburse the state;
 - Transfer title to the property to TEA or another public school; and/or
 - Liquidate the property.
- Clarifies that that property purchased with state funds may not be transferred, sold, or otherwise disposed of without the prior written consent of TEA if the charter holder receives notice of revocation, nonrenewal, or expiration.
- All remaining state funds of a charter holder that ceases to operate must be returned to TEA and deposited in the charter school liquidation fund. TEA may approve a transfer of these remaining funds to an entity that is taking over the operations of the charter that has ceased to operate.
- Requires a charter school to provide an accounting of each parcel of the school's real property, including identifying the amount of local, state, and federal funds used to purchase or improve each parcel.
- Ensures Texans taxpayer dollars remain in Texas by prohibiting the use of state funds to be pledged or used to secure loans or bonds for any other organization or to support a non-charter operation or out-of-state operation affiliated with the charter holder.

- Requires that a charter school, prior to entering a real property transaction with a related entity, provide TEA with an appraisal of the property. Gives TEA the authority to reclassify transactions between a charter holder and a related entity if TEA believes the transaction was not in the material interest of the charter holder.
- If entering into a financial transaction with a related entity, the charter school must include the business operations of the affiliated company in the school's annual financial report.
 - Including all financial transactions between the charter school and the affiliated company, the total compensation and benefits of board members, officers, and administrators of the school and affiliated company, and each member related to a board member, officer or administrator.
- Allows a board of managers to access and manage the former charter holder's bank account that contains state funds and sell or transfer property to another charter holder or district.

As proposed, S.B. 1658 amends current law relating to the ownership, sale, lease, and disposition of property and management of assets of an open-enrollment charter school.

RULEMAKING AUTHORITY

Rulemaking authority is expressly granted to the commissioner of education in SECTION 3 (Section 12.106, Education Code), SECTION 6 (Sections 12.1166 and 12.1167, Education Code), SECTION 8 (Sections 12.1281, 12.1282, 12.1283, and 12.1284, Education Code), SECTION 9 (Section 12.141, Education Code), and SECTION 13 (Section 44.008, Education Code) of this bill.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Section 12.1012, Education Code, by adding Subdivisions (7) and (8), to define "payable obligation" and "remaining funds."

SECTION 2. Amends Subchapter D, Chapter 12, Education Code, by adding Section 12.10125, as follows:

Sec. 12.10125. OPEN-ENROLLMENT CHARTER SCHOOL NOT IN OPERATION. Provides that an open-enrollment charter school ceases to operate if:

- (1) the school's charter has been revoked, has been denied renewal, has expired, has been surrendered, or has been abandoned; or
- (2) the school has otherwise ceased operation as a public school.

SECTION 3. Amends Section 12.106, Education Code, by adding Subsections (d), (e), and (f), as follows:

(d) Requires that all remaining funds of a charter holder for an open-enrollment charter school that ceases to operate, except as provided by Subsection (e), be returned to the Texas Education Agency (TEA) and deposited in the charter school liquidation fund.

(e) Authorizes TEA to approve a transfer of a charter holder's remaining funds to another charter holder if the charter holder receiving the funds:

- (1) has not received notice of the expiration or revocation of the charter holder's charter for an open-enrollment charter school or notice of a reconstitution of the governing body of the charter holder under Section 12.1141 (Renewal of Charter; Denial of Renewal; Expiration) or 12.115 (Basis for Charter Revocation or Modification of Governance); and

(2) has been approved for an expansion amendment or been assigned the operation of the former charter school that ceased to operate.

(f) Authorizes the commissioner of education (commissioner) to adopt rules specifying certain matters.

SECTION 4. Amends Section 12.107(a), Education Code, as follows:

(a) Provides that funds received under Section 12.106 (State Funding), after September 1, 2001, by a charter holder, are prohibited from being pledged or used to secure loans or bonds for any other organization, including a non-charter operation or out-of-state operation affiliated with the charter holder, or being used to support a non-charter operation or out-of-state operation affiliated with the charter holder.

SECTION 5. Amends Section 12.1163, Education Code, by adding Subsection (d), as follows:

(d) Authorizes an audit under Subsection (a) (relating to authorizing the commissioner to audit certain records) to include the review of any real property transactions between the charter holder and an affiliated company, as defined by commissioner rule adopted under Section 12.1166. Authorizes the commissioner, if the commissioner determines that a sale and leaseback transaction or similar transaction was structured in a manner that did not benefit the open-enrollment charter school or that the transaction was in excess of fair market value as determined under Section 12.1166, to order that the transaction be reclassified or that other action be taken as necessary to protect the school's interests. Provides that failure to comply with the commissioner's order is a material violation of the charter.

SECTION 6. Amends Subchapter D, Chapter 12, Education Code, by adding Sections 12.1166 and 12.1167, as follows:

Sec. 12.1166. VALUATION OF CERTAIN REAL PROPERTY TRANSACTIONS. (a) Requires the commissioner to adopt a rule defining an affiliated company for purposes of this section.

(b) Requires an open-enrollment charter school, before an open-enrollment charter school is authorized to enter into a real property transaction with an affiliated company, to provide an appraisal of the property to TEA. Requires the school to pay for the appraisal required under this section.

(c) Authorizes the commissioner to adopt rules to implement this section. Authorizes rules adopted under this section to require:

- (1) an open-enrollment charter school to obtain commissioner approval of the appraiser;
- (2) the commissioner to publish a list of acceptable appraisers;
- (3) the appraiser to use specific methods for the appraisal; or
- (4) the appraisal to be filed with TEA.

Sec. 12.1167. FINANCIAL REPORT OF CERTAIN SCHOOLS. (a) Defines "affiliated company."

(b) Requires an open-enrollment charter school that enters into a financial transaction with an affiliated company for the sale or lease of real property to include the business operations of the affiliated company in the school's annual financial report.

(c) Requires a financial report subject to Subsection (b) to separately disclose:

(1) all financial transactions between the open-enrollment charter school and the affiliated company, separately stating the principal, interest, and lease payments; and

(2) the total compensation and benefits for:

(A) each member of the governing body and each officer and administrator of the school and the affiliated company; and

(B) each person related to a member, officer, or administrator under Paragraph (A) in the third degree by consanguinity or affinity, as determined under Chapter 573 (Degrees of Relationship; Nepotism Prohibitions), Government Code.

(d) Authorizes the commissioner to adopt rules to implement this section.

SECTION 7. Amends Section 12.128, Education Code, by amending Subsections (a) and (c), and adding Subsections (a-1), (b-1), (b-2), (c-1), (c-2), and (f), as follows:

(a) Provides that property purchased, rather than purchased or leased, with funds received by a charter holder under Section 12.106 after September 1, 2001 is considered to be public property for all purposes under state law, is property of this state held in trust by the charter holder for the benefit of the students of the open-enrollment charter school, and is authorized to be used only for a purpose for which a school district may use school district property.

(a-1) Provides that property leased with funds received by a charter holder under Section 12.106 after September 1, 2001, is considered to be public property for all purposes under state law, is property of this state held in trust by the charter holder for the benefit of the students of the open-enrollment charter school, and is authorized to be used only for a purpose for which a school district may use school district property.

(b-1) Provides that, subject to Subsection (b-2), while an open-enrollment charter school is in operation, the charter holder holds title to any property described by Subsection (a) or (b) and is authorized to exercise complete control over the property as permitted under the law.

(b-2) Prohibits a charter holder from transferring, selling, selling, or otherwise disposing of any property without the prior written consent of TEA if:

(1) the charter holder has received notice of the expiration of the charter holder's charter under Section 12.1141 (Renewal of Charter; Denial of Renewal; Expiration), and the charter has not been renewed, or the charter's revocation under Section 12.115(c) (relating to requiring the commissioner to revoke the charter of an open-enrollment charter school under certain circumstances);

(2) the charter holder has received notice that the open-enrollment charter school is under discretionary review by the commissioner, which may result in the revocation of the charter or a reconstitution of the governing body of the charter holder under Section 12.115; or

(3) the open-enrollment charter school for which the charter is held has otherwise ceased to operate.

(c) Requires the commissioner to supervise the disposition of the property in accordance with this subchapter, rather than law.

(c-1) Requires TEA, notwithstanding Subsection (c), if an open-enrollment charter school ceases to operate:

(1) for property purchased with state funds, to direct the charter holder to dispose of the property through one of the following methods:

(A) retain the property and provide reimbursement to the state as provided by Section 12.1281;

(B) transfer the property to TEA under Section 12.1281(h), or a school district or open-enrollment charter school under Section 12.1282;

(C) liquidate the property under Section 12.1283;

(D) close the operations of the open-enrollment charter school under Section 12.1284; or

(E) take any combination of the actions described by Subdivisions (A), (B), (C), and (D); and

(2) for property leased with state funds, is authorized to direct the charter holder to assign the charter holder's interest in the lease to TEA.

(c-2) Authorizes TEA to approve an expenditure of remaining funds by a former charter holder for improvements to property described by this section if TEA determines that the expenditure is reasonably necessary to dispose of the property or preserve the property's value.

(f) Provides that a decision by TEA under this section is final and may not be appealed.

SECTION 8. Amends Subchapter D, Chapter 12, Education Code, by adding Sections 12.1281, 12.1282, 12.1283, and 12.1284, as follows:

Sec. 12.1281. DISPOSITION OF PROPERTY PURCHASED WITH STATE FUNDS.

(a) Authorizes a former charter holder of an open-enrollment charter school that has ceased to operate to retain property described by Section 12.128 (Property Purchased or Leased With State Funds) if the former charter holder reimburses the state with non-state funds for the amount of state funds used to purchase the property and the former charter holder provides written assurance that the requirements of Section 12.1284 will be met, and receives approval from TEA.

(b) Authorizes the former charter holder, on receiving consent from TEA under Section 12.128(b-2) and a written agreement from any creditor with a security interest described by Section 12.128(e) (relating to this section not affecting a security interest on or lien on property established by a creditor in certain circumstances), to sell property for fair market value or transfer property to an open-enrollment charter school or a school district as provided under Section 12.1282.

(c) Provides that the amount of funds the state is entitled to as reimbursement for property of a former charter holder is:

(1) for property retained by the former charter holder, the current fair market value less the remaining principal on any debt subject to a security interest or lien described by Section 12.128(e); or

(2) for property sold by the former charter holder, the net sales proceeds of the property multiplied by the percentage of state funds used to purchase the property.

(d) Requires TEA, to determine the amount of state funds a former charter holder used to purchase property, to calculate certain reimbursements.

(e) Requires a former charter holder retaining property under Subsection (a) or selling the property under Subsection (b)(1) to:

(1) if retaining the property, file an affidavit in the real property records of the county in which the property is located disclosing the state interest in the property, or selling the property, provide written assurance that the requirements of Section 12.1283 have been met;

(2) place in escrow with the Texas comptroller of public accounts (comptroller) an amount of non-state funds equal to 110 percent of the estimated state reimbursement amount; and

(3) not later than two weeks after the date the charter holder's final financial audit is filed under Section 44.008 (Annual Audit; Report), submit to the state the final state reimbursement amount using the funds in escrow in addition to any other funds necessary to pay the full amount of state reimbursement.

(f) Authorizes a former charter holder to retain any funds remaining after complying with this section.

(g) Requires TEA, as soon as TEA is satisfied that the former charter holder complied with Subsection (e), to issue written notice of the release of the state interest in property the former charter holder retains under this section and authorize the return of any funds not used for state reimbursement to the former charter holder.

(h) Requires the former charter holder, if a former charter holder does not dispose of property under Subsection (a) or (b), to transfer the property, including a conveyance of title, to TEA in accordance with the procedures and time requirements established by TEA.

(i) Requires the Texas attorney general (attorney general), if TEA determines a former charter holder failed to comply with this section or Section 12.1282, on request of TEA, to take any appropriate legal action to compel the former charter holder to convey title to TEA or other governmental entity authorized by TEA to maintain or dispose of property.

(j) Provides that a decision by TEA under this section is final and may not be appealed.

(k) Authorizes the commissioner to adopt rules necessary to implement this section.

Sec. 12.1282. TRANSFER OF PROPERTY PURCHASED WITH STATE FUNDS. (a) Authorizes TEA to approve the transfer of property described by Section 12.128 from an open-enrollment charter school that has ceased to operate, or to transfer property conveyed to TEA by the former charter holder under Section 12.1281, to a school district or an open-enrollment charter school if:

(1) the open-enrollment charter school or school district receiving the property agrees to the transfer, and agrees to identify the property as purchased wholly or partly using state funds on the school's annual financial report filed under Section 44.008;

(2) any creditor with a security interest in or lien on the property described by Section 12.128(e) agrees to the transfer; and

(3) the transfer of the property does not make the open-enrollment charter school that ceases to operate insolvent.

(b) Provides that property received by an open-enrollment charter school or school district under this section is considered to be state property under Section 12.128(a).

(c) Authorizes the commissioner to adopt rules necessary to administer this section, including rules establishing qualifications and priority for a school district or open-enrollment charter school to receive a transfer of property under this section.

(d) Authorizes TEA, if TEA determines that the cost of disposing of personal property described by Section 12.128 transferred to TEA by an open-enrollment charter school that ceases to operate exceeds the return of value from the sale of the property, to distribute the personal property to open-enrollment charter schools and school districts in a manner determined by the commissioner.

(e) Provides that a determination by TEA under this section is final and may not be appealed.

Sec. 12.1283. SALE OF PROPERTY PURCHASED WITH STATE FUNDS. (a) Authorizes TEA, after TEA receives title to property described by Section 12.128, to sell the property at any price acceptable to TEA.

(b) Requires the following agencies, on request of TEA, to enter into a memorandum of understanding to sell property for TEA:

(1) for real property, the General Land Office (GLO); and

(2) for personal property, the Texas Facilities Commission (TFC).

(c) Requires that proceeds from the sale of property under this section be deposited in the charter school liquidation fund.

(d) Authorizes the commissioner to adopt rules necessary to administer this section.

Sec. 12.1284. CLOSURE OF CHARTER SCHOOL OPERATIONS. (a) Requires a former charter holder, after extinguishing all payable obligations owed by an open-enrollment charter school that ceases to operate, including a debt described by Section 12.128(e), to:

(1) remit to TEA any remaining funds described by Section 12.106(d), and any state reimbursement amounts from the sale of property described by Section 12.128; or

(2) transfer the remaining funds to another charter holder under Section 12.106(e).

(b) Requires TEA to deposit any funds received under Subsection (a)(1) in the charter school liquidation fund.

(c) Authorizes the commissioner to adopt rules necessary to administer this section.

SECTION 9. Amends Subchapter D, Chapter 12, Education Code, by adding Section 12.141, as follows:

Sec. 12.141. RECLAIMED FUNDS. (a) Requires TEA to deposit funds received under Sections 12.106, 12.128, 12.1281, 12.1283, and 12.1284 into the charter school liquidation fund and is authorizes TEA to use the funds for certain expenditures.

(b) Prohibits TEA from using funds under this section until the commissioner determines if the open-enrollment charter school that ceases to operate received an overallocation of funds under Section 12.106 that must be recovered for the foundation school program.

(c) Requires TEA to annually review the amount of funds in the charter school liquidation fund and transfer any funds exceeding \$2 million for use in funding a high-quality educational grant program established by the commissioner, or to the comptroller to deposit in the charter district bond guarantee reserve fund under Section 45.0571 (Charter District Bond Guarantee Reserve Fund).

(d) Authorizes TEA to delay a transfer of funds under Subsection (c) if the excess is less than \$100,000. Provides that funds set aside for an overallocation of funds from the foundation school program are not included in determining whether the amount of funds exceeds \$2 million.

(e) Authorizes the commissioner to adopt rules necessary to implement this section.

SECTION 10. Amends Section 39.1121, Education Code, by adding Subsection (c-1), as follows:

(c-1) Provides that a board of managers appointed for the final closure of a former open-enrollment charter school under Subsection (c) (relating to term limits for board of managers for an open-enrollment charter school or a campus of an open-enrollment charter school) has the authority to:

(1) access and manage any former charter holder's bank account that contains funds received under Section 12.106; and

(2) subject to approval by a creditor with a security interest in or lien on property described by Section 12.128 and in accordance with Section 12.1282, sell or transfer to another charter holder or school district any property titled to the former charter holder that is identified in the former open-enrollment charter school's annual financial report filed under Section 44.008 as being acquired, wholly or partly, with funds received under Section 12.106.

SECTION 11. Amends Section 39.1122, Education Code, by amending Subsection (c), as follows:

(c) Requires TEA, rather than the commissioner, to use funds received by or due to the former charter holder under Section 12.106 or funds returned to the state from liquidation of property, rather than state property, described by Section 12.128 and held by a former charter holder for compensation of a member of a board of managers for an open-enrollment charter school or a campus of an open-enrollment charter school or a superintendent.

SECTION 12. Amends Section 43.001(a), Education Code, as follows:

(a) Provides that the permanent school fund, which is a perpetual endowment for the public schools of this state, except as provided by Subsection (b), consists of, among other land, investments, and proceeds, all of the unappropriated public domain remaining in this state, including all land recovered by the state by suit or otherwise except pine forest land as defined by Section 88.111 (Forest Land Acquired by State Under Tax Sale), and property described by Section 12.128.

SECTION 13. Amends Section 44.008, Education Code, by adding Subsections (f), (g), and (h), as follows:

(f) Requires an open-enrollment charter school to provide an accounting of each parcel of the school's real property, including identifying the amount of local, state, and federal funds used to purchase or improve each parcel of property.

(g) Requires an open-enrollment charter school for which the charter has expired, been revoked, been denied renewal, or been surrendered or an open-enrollment charter school that otherwise ceases to operate to submit a final annual financial report to TEA. Requires that the report verify that all state property held by the charter holder has been returned or disposed of in accordance with Section 12.128.

(h) Authorizes the commissioner to adopt rules necessary to implement this section, including rules defining local funds.

SECTION 14. Provides that a transfer of property from an open-enrollment charter school that ceases to operate to another open-enrollment charter school that occurred before January 1, 2016, is ratified if both open-enrollment charter schools classified the property as purchased with state funds on each school's annual financial report under Section 44.008, Education Code.

SECTION 15. Effective date: upon passage or September 1, 2017.