

Science Academies of New York Charter Schools

Purchase versus Lease of Buildings

MARCH 2018



OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

Contents

- Report Highlights 1**

- Purchase versus Lease of Buildings 2**
 - What Process Should The Board Use In Obtaining Buildings? 2
 - The Board Did Not Perform a Cost-Benefit Analysis. 3
 - What Do We Recommend? 5

- Appendix A – Response From SANY Officials 6**

- Appendix B – OSC Comments on the SANY’s Response 14**

- Appendix C – Audit Methodology and Standards 18**

- Appendix D – Resources and Services 19**

Report Highlights

Science Academies of New York Charter Schools

Audit Objective

Determine whether the Board conducted an appropriate cost-benefit analysis when deciding whether to lease or purchase school buildings.

Key Findings

- SANY officials did not analyze purchasing options before deciding to lease buildings.
- We estimate SANY could have achieved savings of nearly \$3 million over the 15-year terms of the leases by purchasing and renovating the four buildings acquired during our audit period rather than leasing them.

Key Recommendations

- Perform and document a thorough cost-benefit analysis of leasing versus purchasing buildings to ensure the best interests of SANY are met.
- The Board should explore purchasing its school buildings.

School officials generally disagreed with our findings. However, they indicated they would take corrective action. Appendix B includes our comments on the School's response letter.

Background

The Science Academies of New York Charter Schools (SANY) has school buildings located in the City of Syracuse and the Town of Geddes in Onondaga County, the City of Utica in Oneida County and the Town of Frankfort in Herkimer County. Its administrative office is located in the City of Syracuse.

The seven-member Board is responsible for the general management and control of SANY's financial and educational affairs. The Superintendent is SANY's chief executive officer and is responsible, along with administrative staff, for day-to-day management under the Board's direction. The Assistant Superintendent of Finance oversees SANY's business operations.

Quick Facts

2017-18 Budgeted Appropriations	\$21.6 million
Employees	249
Enrollment	1,593
Buildings	7

Audit Period

July 1, 2014 – July 31, 2017

Purchase versus Lease of Buildings

Three schools chartered by the New York State Board of Regents merged on July 1, 2017 to become SANY. Those schools are: Syracuse Academy of Science Charter School (SASCS), Utica Academy of Science Charter School (UASCS) and Syracuse Academy of Science and Citizenship Charter School (SASCCS). While each school was originally a stand-alone entity, they operated under the same management team. SASCS began in 2003, UASCS began in 2012 and SASCCS began in 2016.

SANY operates six school buildings¹ and one administrative office. All but one building² are leased from Terra Science and Education Incorporated (Terra), a non-profit organization that was created to support SANY schools. Besides being the landlord, Terra partners with SANY by providing awards, grants and scholarships to SANY students and teachers. The SANY Board President also serves as the Terra Board President.³

The leases between Terra and SANY have 15-year terms with annual rent increases of 4 percent or the rate of inflation according to the Consumer Price Index, whichever is greater.⁴ The leases require Terra to carry liability insurance and make all structural repairs and major renovations to the buildings. SANY must also carry liability insurance and is responsible for paying property taxes and making minor repairs. If repair costs exceed a designated amount per lease, the excess is split between SANY and Terra. During 2016-17, SANY made lease payments to Terra totaling about \$1.2 million.

What Process Should The Board Use In Obtaining Buildings?

The Board is entrusted with the responsibility of safeguarding SANY resources. The Board should fulfill this responsibility, in part, by fully evaluating existing options before committing these resources. When acquiring property, the Board and SANY officials should analyze every scenario, such as how much it will cost to buy a building and make necessary renovations to it versus the cost of leasing over a period of time. By completing an appropriate cost-benefit analysis of each available option, SANY officials would have greater assurance that the option chosen is the most economical way to meet their needs, both in the short- and long-term.

1 SASCS elementary, middle and high schools; UASCS middle and high schools; SASCCS elementary school

2 UASCS middle school, which is leased from a church

3 According to officials, these are both unpaid positions. The SANY Board President disclosed his interest in the leases and abstained from voting on them. Although he is deemed to have an interest in the lease by virtue of being a member and officer of the not-for-profit, the interest is not prohibited because of a statutory exception in the law.

4 In September 2017, SANY and Terra signed a lease addendum to four of the lease agreements that gives SANY the right to terminate each lease for any reason without penalty, as long as it provides Terra with 10 months' notice prior to termination. In the event of such early termination, SANY shall forfeit its security deposit. One lease, SASCCS Elementary School, already had this provision.

The Board Did Not Perform a Cost-Benefit Analysis

Before leasing buildings, the Board usually hires an outside firm to perform a rent analysis based on the cost per square foot in comparison to other buildings in the area. Based on these analyses, SANY was receiving a fair price for the leased buildings at the beginning of the leases. However, the Board did not explore other options such as determining whether purchasing the buildings would have been more cost effective than leasing them.

We performed a cost analysis of the four buildings that were leased during our audit period. Our analysis compares the cost of lease payments with 4 percent annual increases over a 15-year period, with the cost of purchasing (including loan interest) and renovating the buildings.⁵ SANY officials provided us with information it received from Terra on past renovations made to the four buildings and projected costs of future building renovations. Because the renovation costs were paid by Terra and not SANY, we were unable to verify the information provided. Assuming the cost of completed and future renovations are accurate, we estimate SANY could have achieved savings of nearly \$3 million from August 2014 to June 2032⁶ by acquiring and renovating the buildings rather than leasing them.

Figure 1: Cost Analysis for School Building Leases

	SASCS Middle School	SANY Office	UASCS High School	SASCCS Elementary School	Totals
Acquisition Date	August 2014	December 2014	April 2015	March 2017	
Building Cost (Principal plus Interest)	\$515,000	\$132,000	\$615,000	\$974,000	\$2,236,000
Completed Renovation Costs^a	\$1,055,000	\$517,000	\$417,000	\$718,000	\$2,707,000
Projected Cost of Planned Renovation	\$1,157,000	\$42,000	\$3,385,000	\$1,645,000	\$6,229,000
Property Insurance	\$88,000	\$9,000	\$96,000	\$110,000	\$303,000
Total Ownership Cost	\$2,815,000	\$700,000	\$4,513,000	\$3,447,000	\$11,475,000
Lease Payments	\$3,916,000	\$582,000	\$4,877,000	\$5,065,000	\$14,440,000
Difference	(\$1,101,000)	\$118,000	(\$364,000)	(\$1,618,000)	(\$2,965,000)

^a Because the renovation costs are paid by Terra and our audit scope (and authority) is limited to SANY for this audit, we did not verify the renovation costs.

⁵ We also included property insurance as part of the total ownership cost. This was based on the past four years' actual premiums and an estimate for future years assuming 3 percent increases each year.

⁶ The lease terms are 15 years. SASCS Middle School and SANY Office estimates are from 2014 to 2029; UASCS High School is from 2015 to 2030; SASCCS Elementary School is from 2017 to 2032.

SANY officials provided several reasons as to why they decided to lease rather than purchase the buildings, such as financial resources, educational focus, rent analysis, liability and Terra's supporting role. They told us it would have been difficult for the original charter schools (eg. SASCS, UASCS) to purchase the buildings when they first began operations because they did not have cash and were unsure if they would be able to get a loan. They also felt that taking on the duties to purchase, finance and renovate the buildings would divert substantial amounts of time and resources from their educational mission. Instead, they relied on the rent analysis to determine whether the rents were reasonable.

Officials also identified Terra's role as a supporting entity to SANY. They told us Terra supports SANY by funding programs; providing scholarships, awards and incentive payments to students and teachers; and by managing and paying for major building improvements. However, about 85 percent of Terra's revenue is derived from SANY's rent.⁷ Therefore, Terra is using SANY's rent to pay for mortgages, renovations and school programming and scholarships. While some of the income generated by Terra from the lease arrangements may be directed back to SANY for its programs and students, there is no guarantee that this will always be the case. Had SANY purchased and renovated the buildings directly rather than leasing them through Terra, it could have used the savings to benefit the programs and students.

In addition, a lease addendum increased the rent on the SASCS high school by \$27,990 per year, starting in July 2014.⁸ However, the addendum did not indicate any reason for the increase in rent. SANY officials told us the increase was due to air conditioning and high-efficiency boiler improvements made by the landlord, which they consider to be amenities. However, lease terms indicate that Terra pays for major renovations and SANY pays for minor repairs like plumbing, heating, electrical and air conditioning systems as long as the cost is less than \$15,000 per repair. For repairs over \$15,000, they should split the excess amount. Significant heating and air conditioning work is also included in the landlord-paid renovation costs for other buildings in Figure 1, without any mention of increasing rent as a result. For these reasons, we question the appropriateness of the increase. With 4 percent annual rent increases included in the lease, this amounts to \$420,568 above what SANY would have paid under original lease terms.

7 Based on Terra's Internal Revenue Service Form 990 - Return of Organization Exempt From Income Tax

8 The SANY office was added to the SASCS high school lease as an addendum. We discovered the rent increase when reviewing the lease and its two addendums.

What Do We Recommend?

The Board should:

1. Perform and document a thorough cost-benefit analysis of leasing versus purchasing buildings to ensure the SANY's best interests are met.
2. Explore purchasing its school buildings.

Appendix A: Response From SANY Officials



DISTRICT OFFICE
1409 WEST GENESSEE ST. SYRACUSE, NY 13204
PHONE: 315-671-5470 FAX: 315-671-5475
INFO@SASCS.ORG

February 20, 2018

VIA ELECTRONIC MAIL

Rebecca Wilcox, Chief Examiner
Office of the New York State Comptroller
Syracuse Regional Office
333 E. Washington Street
Syracuse, New York 13202-1428

Re: Report of Examination (2017M-279).

Dear Ms. Wilcox:

I am submitting this response to your office's Draft Report of Examination on behalf of the Board of Trustees ("Board") of the Science Academies of New York Charter Schools ("SANY").¹ At the outset, we wish to thank you and your office for accepting the invitation of the Syracuse Academy of Science Charter School ("SASCS") to audit its financial records and operations under Education Law § 2854(1)(c) and for the time and diligence the audit team spent doing so. Our invitation was sent with the purpose of demonstrating the progress we have made since your office's last visit, and in hopes of receiving a clean bill of health such as the report provided to the Utica Academy of Science in 2015. Our interactions with your team were positive and helpful, and we are pleased your team found no irregularities with SANY's financial policies, operations or records for purchasing, disbursements, human resources, and payroll during your initial risk analysis.

After the audit had been underway for a number of weeks, the Office of the Comptroller decided to refocus the audit exclusively on the decision of the SASCS and the Utica Academy of Science Charter School ("UASCS") to lease their school buildings, rather than purchase and renovate them. The draft report states that the Board of Trustees for SASCS and UASCS did not conduct a sufficient analysis of the pros and cons of leasing these facilities versus purchasing them.

On the other hand, your office found the rental analysis, negotiated rental rate, which is around \$5.50 per sqf including extensive renovations (with comparison to similar educational buildings in CNY), and rental agreements were acceptable.

See Note 1 Page 14

¹ The draft report is undated. It was provided to me on January 17, 2018.

Building success one Atom at a time
www.SASCS.org | www.UASCS.org | www.SASCCS.org

We respectfully disagree with the Office of the Comptroller since two major costs are missing in their calculation, if the buildings were purchased by the school:

See
Note 2
Page 14

1. Interest expenses for the completed construction cost, and

2. Human capital cost for working with real estate, architect, vendors and general contractors, financial organizations to acquire loans, and managing the four buildings considered in this report.

See
Note 3
Page 14

After accounting for these two costs, the possible savings drops to about \$7,500 for each building per year, over the 15-year term of the leases. However, this possible savings comes at the cost of the charter schools accepting the risk and liabilities that come with building ownership.

The report also does not consider the historical facts that affected the schools' ability to purchase a school building. SANY was formed in July 2017 as a result of the Board of Regents' approval of the merger application of SAS and UAS. SAS had started in 2003, and UAS was formed in 2013 as separate education corporations with separate boards of trustees. Accordingly, when UAS was formed, it had no credit history, no collateral and no savings with which to finance the purchase of a building. Without such assets, it was unable to finance the purchase of a building. In other words, a lease was its only option.

See
Note 1
Page 14

See
Note 4
Page 14

The report fails to account these items and other significant considerations that informed board's decision for leasing instead of buying school buildings. The following will summarize many of those considerations.

A. General Considerations

First, the draft report does not address a number of realities that informed the Board's decision to lease the school buildings instead of purchasing them. For example, charter schools are ineligible for capital or building aid. Therefore, although charter schools are intended to promote innovative approaches to education and provide their communities with viable educational alternatives, they must do so relying only on their own resources. To date, only New York City has offered charter schools with acceptable school facilities at beneficial lease rates. While that program is a significant benefit to charter schools in New York City, all other charter schools must fend for themselves to obtain appropriate school buildings and facilities. However, their ability to finance the costs of purchasing and/or renovating school buildings are substantially limited by their inability to pledge charter school tuition as collateral for such financing (Educ. Law § 2853(3)(b)).

Given these factors, purchasing a school building was not possible for SASCS in its first several years of existence, and it was never a possibility for UASCS. As start-up charter schools without the ability to pledge charter school tuition – *i.e.*, their only revenue – neither school could obtain financing to purchase and renovate a school building at competitive rates. Even if they could have done so, the cost of purchasing and renovating the buildings would have been substantially increased by financing costs, including the interest that would have accrued over the life of a mortgage. At the times in question, commercial mortgage and construction loans

See
Note 5
Page 15

commanded interest rates that were, conservatively, between 5 to 6% per year, which would have increased the cost of purchasing the buildings by approximately \$750,000 – \$1 million over a 15-year mortgage. Although the report acknowledges that such costs would have had to be incurred to purchase the properties, it fails to account for this cost in its estimated calculation of the cost of purchasing the properties.

See
Note 6
Page 15

Additionally, purchasing the properties would have substantially expanded each charter school’s portfolio of potential liability. Such liability includes the full risk of loss because of fire or other casualty, increased premises liability, and the potential for environmental liability that is particular to older properties, such as those leased by the charter schools. It also would have required SASCS and UASCS to assume the entire risk of loss of major building components, such as HVAC, roof, and structural components, instead of shifting much of that risk to a landlord. Had the charter schools incurred this liability, they would have had to fund appropriate reserve accounts to pay for replacement of major building components, and the report fails to account for this expense.

See
Note 7
Page 15

See
Note 8
Page 15

B. The Board’s Exercise of Due Diligence

The draft report unfairly implies that the Boards of Trustees for SASCS and UASCS failed to exercise due diligence when they selected the lease option. This assertion is neither supported nor accurate, since such due diligence and discussion took place in 2010-2011 regarding leasing vs purchasing school buildings. These discussions were shared with comptroller office during their first audit report in 2013 and were found acceptable at the time. The board at the time decided that the schools’ focus should be on education and therefore should not dedicate any time for real estate acquiring, managing, and renovations, similar to Federal and State governments which chose rent vs purchasing even though they have the financial capability of purchasing.

See
Note 9
Page 16

See
Note 10
Page 16

As we have previously detailed for your office, the Board retained real estate professionals to advise it on these matters and it consulted closely with its counsel. Moreover, its Treasurer in 2010 was a professor of finance at the Syracuse University Whitman School of Management who specialized in real estate finances and has advised the United States Government on such matters. Based on the advice of these professionals and the information provided by its administrators, who had carefully researched these issues, the Board concluded that it was in each corporation’s best interests to lease the school buildings, rather than purchase them. The Board took into account that the cost of purchasing, renovating, and managing these properties would have imposed a substantial drain on each charter school’s finances and limited the resources available for its primary mission of education. Further, as detailed below, *infra*, managing the extensive renovation projects necessary for these properties and their operations after purchase require personnel that neither charter school employed and would have been a substantial diversion of the corporation’s resources and a substantial increase in its potential liability.

See
Note 9
Page 16

See
Note 3
Page 14

The Board’s Treasurer advised the Board that most entities lease their facilities, rather than purchase them, because it allows their personnel to focus on the entity’s primary core mission. In this regard, he gave the Board several examples, including State and Federal agencies. In fact, the New York State Office of the Comptroller has recently leased 39 buildings and offices across New York State. (See [Office of the Comptroller, Open Book, Leases of the New York State Office of the Comptroller](#) (last accessed, February 15, 2018).

The Board also considered that the majority of charter schools lease their facilities, rather than purchase them. They do so for several reasons: (1) the short time (5-6 months) between charter approval and the required date to commence operations; (2) the substantial cost of purchasing and renovating buildings, including the cost of financing; (3) the inability to use charter school tuition as collateral to finance the purchase and renovation of school facilities; (4) charter school personnel lacking training and experience in negotiating financing terms, managing construction projects, and managing property; (5) the cost of establishing proper cash reserves to provide for replacement of major building components; and (6) liability considerations, including environmental liability.

Of course, the law places the discretion to make this decision in the Board of Trustees. Board members are required to exercise this discretion “in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.” (Not-For-Profit Corporation Law (“NPCL”) § 717(a)). The law permits them to rely on information and opinions, *inter alia*, provided by the corporation’s officers or employees whom they believe to be reliable and competent in such matters, as well as counsel and other professionals regarding matters in which they have expertise or competence. (NPCL § 717(b)).²

The Board spent hours considering a lot of information from a variety of sources to determine the best option for acquiring acceptable school buildings before choosing the lease option. This information included an analysis of the prevailing market lease rates for similar properties, relative to square footage and quality, and the rent being paid by other charter schools, BOCES, and other institutions for similar properties. In addition, the Board obtained and considered professional opinions and information from real estate professionals, finance professionals, its administrators, and its counsel in deciding to lease the school buildings.

The Board diligently negotiated the best possible terms that could have been obtained for the lease agreements, as confirmed by information the Board received from its professional consultants and advisors. It is beyond cavil that the Board achieved superb results: currently, charter schools, BOCES, and other educational institutions pay, on average, between \$ 8.75 per square foot to \$ 23 per square foot in rent. However, of SASCS and UASCS average about \$5.50 per square foot, which includes the cost of substantial renovations.

In short, the Board exercised that degree of care and diligence required by law and more. Its decision to lease the school buildings utilized by SASCS and UASCS were well-informed and soundly based. While the Office of the Comptroller may reach a different conclusion, that is not evidence that the Board failed to exercise proper care in deciding to lease the school buildings, and the report should not suggest otherwise.

See Note 11 Page 16

C. The High Risk Involved in Purchasing the Buildings

Among the factors the Board considered was the substantial risk the charter schools would incur by purchasing the school buildings. This included financing the cost of purchase, plus the cost of substantial renovations. Although charter schools are ineligible for building aid,

² The report indicates that different standards of care applied, such as “perform[ing] and document[ing] a thorough cost-benefit analysis of leasing verses purchasing buildings” and “analyz[ing] every scenario.” However, these suggested standards are inconsistent with the law.

they must comply with the building code requirements of Section 504 of the Rehabilitation Act, the Americans with Disabilities Act, as well as provisions of 8 N.Y.C.R.R. Part 155. Because all of the properties available for purchase or lease were older buildings that failed to meet these requirements, any building selected would require substantial renovations.

Accordingly, purchasing the school buildings would have required charter school representatives to research and select the most competitive financing option; negotiate the mortgages and construction loans; work with design professionals to define the scope of the renovations and their specifications; and manage the construction (*e.g.*, coordinate contractor schedules, supervise the work, manage requests for information and change orders, etc.). At the same time, they would also have to solicit and select quotes for the purchase of necessary furnishings and equipment; solicit and select quotes for the purchase of textbooks and materials; conduct an RFP process for food service operations; conduct and manage communications with parents and students; arrange student transportation; prepare for and conduct an admissions lottery; recruit, vet, and hire qualified teachers and other personnel; and conduct necessary coordination with the Syracuse City School District and New York State Education Department.

Attempting to manage the myriad of tasks that accompanied a purchase of the buildings while simultaneously performing all of the tasks necessary to open a new school would have been a Herculean task, and attempting it would almost certainly have degraded the success of the charter schools. Through the lease option, the Board obtained excellent facilities at prices well below market rates and it removed the entire slate of tasks associated with purchasing the properties from their administrators workload, allowing them to focus exclusively on their educational mission. This consideration was also very important in the Board's analysis. The report seems to, unjustifiably, give such considerations short shrift.

D. Cost of Retaining Personnel With Sufficient Experience in Financing and Property Management

Purchasing such commercial properties and undertaking their extensive renovation requires personnel with knowledge and experience in vetting and negotiating financing options and in managing large construction projects. In addition, it would have required personnel with experience in buildings and grounds management. Neither SASCS nor UASCS retained such personnel and they would have had to retain individuals with such skills if they had purchased the properties. Thus, the Board would have been required to employ such individuals at a substantial cost, which the report does not take into account.

Perhaps most importantly, assuming these responsibilities would have diverted the Board and its administrators from their primary mission: providing innovative and quality education. The sole purpose for the existence of any charter school is to provide their communities with a highly effective education, and they must accomplish this mission with underfunded programs and without building aid, transportation aid, health services aid, and other forms of state aid that benefit public school districts. Therefore, the decision to lease the property's instead of purchasing them is very understandable, and we believe the report should acknowledge these factors – or at least do so without being dismissive of them.

See Note 3 Page 14

E. Findings of Prior Audits

It is noteworthy that the Office of the Comptroller previously audited the charter schools during their leases, including an analysis of the rental rates the schools were paying under their leases and a risk assessment relative to each lease. However, the lease arrangements were not mentioned in either audit report, and the Comptroller’s Office did not indicate it had any reservation about the leases. Therefore, it is both surprising and unfair that it now takes such a critical posture regarding this arrangement, without any prior notice of guidance.

F. The Audit Report’s Misleading Chart

The draft report provides a chart that is supposed to provide an accurate estimate of the cost of purchasing the school buildings, but it omits the substantial cost of financing renovations of the properties, although it acknowledges and accepts the necessity of this significant cost. It also fails to account for closing costs. By excluding these inarguable costs, the report provides a substantially misleading estimated cost relative to the purchase option.

We respectfully submit that, while the following chart does not incorporate all of the costs of purchasing the buildings, it provides a more accurate estimate of those costs.

See
Note 2
Page 14

See
Note 12
Page 16

Figure 1: Cost Analysis for School Building Leases					
	SASCS Middle School	SANY Office	UASCS High School	SASCCS Elementary School	Totals
Acquisition Date	August 2014	December 2014	April 2015	March 2017	
Building Cost (Principal plus Interest)	\$515,000	\$132,000	\$615,000	\$974,000	\$2,236,000
Completed Renovation Costs*	\$1,055,000	\$517,000	\$417,000	\$718,000	\$2,707,000
Interest on Completed Renovation Costs	\$446,717	\$218,913	\$176,570	\$304,022	\$1,146,221
Projected Cost of Planned Renovation	\$1,157,000	\$42,000	\$3,385,000	\$1,645,000	\$6,229,000
Building Insurance	\$88,000	\$9,000	\$96,000	\$110,000	\$303,000
Staff to Purchase, negotiate, arrange the biddings, work with the real estate, Banks, architect and contractors as well as Manage the Buildings for 15 years with 90K (Salary plus Benefits without any Salary Increase)					\$1,350,000
Total Ownership Cost	\$2,727,000	\$691,000	\$4,417,000	\$3,337,000	\$13,971,221
Lease Payments	\$3,916,000	\$582,000	\$4,877,000	\$5,065,000	\$14,440,000
Difference	-\$1,189,000	\$109,000	-\$460,000	-\$1,728,000	\$468,779
<p>*Because the renovation costs are paid by Terra and our audit scope (and authority) is limited to SANY for this audit, we did not verify the renovation costs. (SANY officials were able to provide through Terra all the details of the construction which describes the scope of the work to the Comptroller’s office where the online link to the National average was given as well).</p> <p>**As from the Table, it can be seen the total difference in fifteen years for four buildings is \$468,779. The SANY Board decision stems from spending school officials energy by focusing on our urban youth’s education and contracting those services out as it is in Security service, meal services and so on.</p> <p>***Comptroller’s office made a Subjective assumption in regards to not allocating any interest on the completed construction based on what Syracuse Academy of Science had in its budget. SANY was just approved and SAS money could not be utilized for other than SAS buildings.</p> <p>**** Beside all these the above calculation is irrelevant since any SANY school has the option to leave the building without any penalty within 10 months. Therefore during the 15 year SANY schools secured themselves however if there is an opportunity like in the NYC where charter schools can utilize District schools, SANY has the option to take advantage of it.</p>					

See
Note 13
Page 17

G. Additional Cost of Assuming Responsibility for Loss of the Building and Major Building Components

In addition to the foregoing, the lease arrangements allow the Board to shift a significant portion of the risk regarding a potential catastrophic loss of the buildings and the replacement of their major components onto the landlord. For example, the lease arrangement allows the charter schools to limit their potential damages in the event of a catastrophic loss to just the cost of relocating the school, and this risk can be insured at a much lower cost. It also eliminates the need for the schools to finance reserve accounts to responsibly plan for the replacement of major building components, including the roof and HVAC systems. However, the purchase option would place the entirety of these risks on the charter schools. The draft report also fails to account for these costs.

See
Note 8
Page 15

In regard to both of these contingencies, it is important that both lease agreements give the charter schools the option to terminate the lease agreement on only 10 months' notice. Such a provision is virtually unheard of in a commercial lease and we are not aware of any charter school leasing its facilities having a similar lease provision. It provides the Board with enormous flexibility, allowing it to terminate either lease agreement if an alternative arises providing more beneficial to the charter schools. So, for example, if the same kind of opportunity that Mayor Bloomberg provided charter school students in New York City should materialize for SASCS or UASCS, the Board could take advantage of it. The report should at least acknowledge this extraordinary lease provision and the benefit it provides the charter schools

See
Note 14
Page 17

H. Terra Science's Status As a Not-For-Profit Corporation and Supporter of SANY Schools

Finally, we should bear in mind that Terra Science is a not-for-profit organization that was formed for the purpose of supporting SANY Charter Schools and other nonprofit educational institutions in this region. It has provided SANY Schools and their students with tremendous support, funding multiple scholarships and grants over the years that facilitate the post-secondary education of our students and provides programs that motivate our students and educators and improve their performance. As Superintendent of Schools for SANY, I can attest that had it not been for the support of Terra Science, the Utica Academy of Science Chart School (UASCS) would have suffered and would have faced serious consequences. It has one of the lowest per-pupil charter school tuition rates in New York State, and it is inordinately difficult to find qualified teachers in that locale. Also, UASCS required the lease that Terra Science provided it when it began its operations because the properties available for lease or purchase in its area required substantial renovations and UASCS had neither the resources to pay for purchasing the buildings nor for the renovation. It is very unlikely that, as a start-up, UASCS could have obtained the necessary financing to purchase and renovate these buildings.

I. Conclusion

In conclusion, we believe the report creates an inaccurate impression that the SANY Board of Trustees did not exercise sufficient due diligence in opting to lease the properties instead of purchasing them outright. In this regard, it suggests that the Board's standard of care is substantially different than what the law provides and it fails to account for the multiple considerations the Board took into account in choosing the lease-option, as referenced above. The board still keeps its original thought on keeping its educational focus rather than acquiring and managing real estate properties for its school, as it does for its other services, such as

See
Note 15
Page 17

outsourcing its meal services. In addition, the report provides a misleading estimate of the cost of purchasing and renovating the properties, by neglecting to incorporate the cost of financing renovation of the properties, although the report concedes the charter schools would have had to incur these costs had it purchased the properties. It also fails to incorporate other costs, such as retaining personnel sufficient qualification to arrange the financing, manage the construction, and manage the properties. Finally, it fails to sufficiently recognize the purpose of Terra Science, which was formed for the purpose of assisting SASCS and other nonprofit educational institutions in their formation and operations. The board will discuss the lease vs purchase options for its future school building needs as they rise and will make these analyses available for future audits.

See Note 2 Page 14

See Note 3 Page 14

See Note 16 Page 17

Thank you for this opportunity to comment on the report. While we are constrained to disagree with significant portions of it, we remain appreciative of your office's willingness to accept our offer to come back and audit the schools again, and the constructive and cooperative nature in which your office's personnel worked with our administrators while doing so. Please do not hesitate to contact me if you have any questions or wish to discuss the matter further.

Very truly yours,

Tolga Hayali, Ed.D.
Superintendent of Schools

TH:

Appendix B: OSC Comments on the SANY's Response

Note 1

Our audit scope included all three SANY schools – Syracuse Academy of Science (SASCS), Utica Academy of Science (UASCS) and Syracuse Academy of Science and Citizenship (SASCCS). Each school's Board of Trustees was comprised of the same members who, as of the July 1, 2017 merger of the three schools, are now the members of SANY's Board of Trustees. For consistency, we referenced the SANY Board throughout our report, rather than referencing the SASCS, UASCS and SASCCS Boards.

Note 2

Had SANY purchased the buildings, it would not necessarily have incurred interest expenses for construction costs. It may have been able to pay for renovations by using the savings between the lease and mortgage payment amounts. SANY also has other resources which could reduce their need to borrow. According to their fiscal year ending 2016 financial statements, SASCS had current assets of nearly \$5 million, \$4.8 of which was in cash and cash equivalents (\$3.2 million at FYE 2015; \$2.6 million at FYE 2014).

In addition, SANY and Terra officials told us Terra intends to repay the mortgages in less time than required and to use the rent money to benefit SANY. Examples included making renovations to school buildings and providing scholarships to SANY students. They also indicated that Terra may consider reducing rent after the mortgages are repaid or freezing rent increases. If lease payments are sufficient to cover Terra's ownership costs and have money left over to fund other expenses, one would expect that if SANY owned the buildings it too would have money left to fund other expenses, such as renovations.

Note 3

During our audit period, SANY officials worked with real estate and other organizations to obtain the buildings, so it already incurred some of these costs. The completed and projected renovation estimates shown in Figure 1 of our report include amounts for project management during construction periods, so these costs were factored into our analysis. Furthermore, under the current lease arrangement, SANY is responsible for managing routine maintenance and custodial issues so its staff is already involved with some aspects of building and grounds management.

Note 4

We acknowledge that it might have been difficult for the UASCS to obtain financing when it first started operations; however, officials told us they did not attempt to obtain financing for the purchase of the school buildings, so it is uncertain whether leasing was the only option. SANY officials indicated they

would like to continue to expand their operations in order to help more children in the future. Now that the original charter schools have combined and SANY has accumulated more financial resources, the Board would likely be able to obtain financing more easily for future building acquisitions. Our audit recommendations are intended for SANY officials' consideration going forward. If SANY evaluates financing options and performs a cost analysis for future building acquisitions, it may find that purchasing rather than leasing the buildings is the most beneficial option.

Also, it is worth considering that at the end of the 15-year lease period, SANY will have to keep paying rent on its leased buildings. If SANY purchases its buildings, it would own them after the mortgage is repaid and money would be freed up to fund other programs.

Note 5

Our audit scope period did not include the first years of SASCS's existence. For perspective, we note that SASCS (now SANY) began in 2003. The Board should keep an open mind and compare costs of purchasing and leasing over the long term before committing its resources.

Note 6

The cost of ownership calculated in Figure 1 includes interest costs. We used interest rates in the 5 to 6 percent range. Purchase prices for the four buildings totaled \$1,527,000 and interest costs amounted to \$709,000. Note, however, that the Terra president told us they paid cash for the SANY Office building and for some of its renovations. We took a conservative approach in our analysis and included \$42,000 of interest for the purchase of the SANY Office building to be consistent with our analysis for the other buildings.

Note 7

The cost of ownership in Figure 1 includes the estimated cost of property insurance over a 15- year period for each building. Also, SANY currently pays for liability insurance coverage.

Note 8

Our analysis includes significant planned renovations, including major building components, based on estimates provided by SANY and Terra. Costs totaling \$6,229,000 are included in Figure 1 for planned renovations (e.g., roofs, doors, HVAC, plumbing, electric, and windows). Therefore, additional reserves to pay for future replacement of major building components may not be necessary in the early years of operation.

Note 9

SANY officials may have had discussions in 2010-11 regarding leasing versus purchasing buildings. However, based on the evidence provided, during our audit period (July 1, 2014 through July 31, 2017) SANY leased four buildings without comparing the cost of purchasing the buildings to the cost of leasing.

Note 10

Our 2013 audit examined purchases from selected vendors and the student enrollment and billing processes. SANY has leased four additional buildings since July 2014 and its lease payments over 15 years for these buildings will total at least \$14.4 million. Because this is a material cost for SANY and we found no evidence that SANY had analyzed the purchasing option prior to leasing these buildings, we focused on this area in our current audit.

Note 11

Our audit found that SANY leased four buildings during our audit period without comparing the cost of leasing versus purchasing the buildings and we stated that conclusion in our audit report.

Note 12

SANY's response provided an update to the total ownership cost that we show in Figure 1, but states that their chart does not incorporate all of the costs of purchasing the buildings. If more costs were included, that suggests Terra is taking on a nearly break-even operation, or possibly a loss. This conflicts with what they told us about being able to repay loans early and use the extra rent money to fund SANY programs and provide scholarships, awards and incentive payments to students and teachers. While Terra has some other revenues, it also has other non-SANY programs to fund. Because most of its revenue comes from SANY rent, it seems unlikely that Terra could sustain its SANY programs if the rent did not, at a minimum, cover the building ownership costs. In fact, at our exit conference, officials presented a similar chart that estimated even higher ownership costs, totaling about \$17 million. However, it seems unlikely that an entity would knowingly purchase and renovate these four buildings at a \$2.5 million loss.⁹ As mentioned in our report, we did not verify the completed and projected renovation cost estimates because we did not audit Terra. Officials provided their estimates and we included them in the analysis; however the actual amounts are unknown to us. We did not go so far as to include borrowing costs for renovations.

⁹ \$16,980,757 cost to own the buildings less \$14,440,000 revenue from lease payments would equal a \$2,540,757 million loss.

Note 13

The calculations of the total ownership cost and difference reflected in SANY's chart are inaccurate. Based on the other numbers in the chart, the totals would be as follows:

	SASCS Middle School	SANY Office	UASCS High School	SASCCS Elementary School	Totals
Total Ownership Cost	\$3,261,717	\$918,913	\$4,689,570	\$3,751,022	\$13,971,221
Lease Payments	\$3,916,000	\$582,000	\$4,877,000	\$5,065,000	\$14,440,000
Difference	(\$654,283)	\$336,913	(\$187,430)	(\$1,313,978)	(\$468,779)

The numbers in this chart do not all total across because SANY included its estimated staff costs in the total column on the far right of its chart rather than dividing the cost among the individual buildings.

Note 14

We have noted the option to terminate the lease with ten months' notice in footnote four.

Note 15

Our audit focused on whether or not SANY conducted a cost-benefit analysis when deciding whether to lease or purchase school buildings. We did not evaluate compliance with Not-For-Profit Corporation Law.

Note 16

We did acknowledge Terra's role in our report.

Appendix C: Audit Methodology and Standards

We conducted this audit pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Section 2854 of the New York State Education Law, as amended by Chapter 56 of the Laws of 2014. To achieve the audit objective and obtain valid audit evidence, we performed the following audit procedures:

- We interviewed SANY officials to gain an understanding of the process used in acquiring school buildings.
- We calculated the cost of ownership considering the following:
 - Purchase cost, which was obtained from county real property records.
 - Borrowing cost, based on interest rates likely attainable, based on discussions with officials and our own research.
 - Renovation cost, provided by SANY, prepared by Terra.
 - Property insurance cost, based on Terra's actual costs plus annual increases.
- We calculated the cost of leasing by reviewing lease terms and calculating the total rent payments over the lease duration.
- We compared the costs of purchasing versus leasing to determine which was less expensive.
- We determined what rent payments should be by examining lease terms. Then, we compared rent payments to budgeted and actual rent expenses.
- We reviewed Terra's IRS form I-990s to determine the percentage of their revenue coming from SANY's rent.

We conducted this performance audit in accordance with GAGAS (generally accepted government auditing standards). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

The Board has the responsibility to initiate corrective action. We encourage the Board to prepare a plan of action that addresses the recommendations in this report and forward the plan to our office within 90 days.

Appendix D: Resources and Services

Regional Office Directory

www.osc.state.ny.us/localgov/regional_directory.pdf

Cost-Saving Ideas – Resources, advice and assistance on cost-saving ideas

www.osc.state.ny.us/localgov/costsavings/index.htm

Fiscal Stress Monitoring – Resources for local government officials experiencing fiscal problems

www.osc.state.ny.us/localgov/fiscalmonitoring/index.htm

Local Government Management Guides – Series of publications that include technical information and suggested practices for local government management

www.osc.state.ny.us/localgov/pubs/listacctg.htm#lmgm

Planning and Budgeting Guides – Resources for developing multiyear financial, capital, strategic and other plans

www.osc.state.ny.us/localgov/planbudget/index.htm

Protecting Sensitive Data and Other Local Government Assets – A non-technical cybersecurity guide for local government leaders

www.osc.state.ny.us/localgov/lgli/pdf/cybersecurityguide.pdf

Required Reporting – Information and resources for reports and forms that are filed with the Office of the State Comptroller

www.osc.state.ny.us/localgov/finreporting/index.htm

Research Reports/Publications – Reports on major policy issues facing local governments and State policy-makers

www.osc.state.ny.us/localgov/researchpubs/index.htm

Training – Resources for local government officials on in-person and online training opportunities on a wide range of topics

www.osc.state.ny.us/localgov/academy/index.htm

Contact

Office of the New York State Comptroller
Division of Local Government and School Accountability
110 State Street, 12th Floor, Albany, New York 12236

Tel: (518) 474-4037 • Fax: (518) 486-6479 • Email: localgov@osc.ny.gov

www.osc.state.ny.us/localgov/index.htm

Local Government and School Accountability Help Line: (866) 321-8503

SYRACUSE REGIONAL OFFICE – Rebecca Wilcox, Chief Examiner

State Office Building, Room 409 • 333 E. Washington Street • Syracuse, New York 13202-1428

Tel (315) 428-4192 • Fax (315) 426-2119 • Email: Muni-Syracuse@osc.state.ny.us

Serving: Herkimer, Jefferson, Lewis, Madison, Oneida, Onondaga, Oswego, St. Lawrence counties



Like us on Facebook at facebook.com/nyscomptroller

Follow us on Twitter [@nyscomptroller](https://twitter.com/nyscomptroller)