Office of the New York State Comptroller

Division of Local Government & School Accountability

Broome-Delaware-Tioga Board of Cooperative Educational Services

Real Property Leasing

Report of Examination

Period Covered:

July 1, 2014 – September 22, 2015

2015M-312

Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of Local Government
and School Accountability

May 2016

Dear Board of Cooperative Educational Services (BOCES) Officials:

A top priority of the Office of the State Comptroller is to help BOCES officials manage BOCES resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support BOCES operations. The Comptroller oversees the fiscal affairs of BOCES statewide, as well as BOCES' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving BOCES operations and Board of Cooperative Educational Services governance. Audits also can identify strategies to reduce BOCES costs and to strengthen controls intended to safeguard BOCES assets.

Following is a report of our audit of the Broome-Delaware-Tioga BOCES, entitled Real Property Leasing. This audit was conducted pursuant to Article V, Section 1 of the State Constitution and the State Comptroller's authority as set forth in Article 3 of the New York State General Municipal Law.

This audit's results and recommendations are resources for BOCES officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

Office of the State Comptroller
Division of Local Government
and School Accountability

Introduction

Background

The Broome-Delaware-Tioga Board of Cooperative Educational Services (BOCES) is a public organization created to provide shared educational programs and services to 15 component school districts (districts). BOCES is governed by a seven-member Board of Education (Board) elected by the boards of the districts. The Board is responsible for the general management and control of BOCES' financial and educational affairs. The District Superintendent is the chief executive officer of BOCES and is responsible, along with other administrative staff, for the day-to-day management of BOCES and for regional educational planning and coordination.

BOCES employs about 1,200 full- and part-time staff. In total, the districts educate approximately 35,000 students in Broome, Delaware and Tioga Counties. BOCES owns its main campus, which houses administrative offices and some of its instructional support services. As of September 2015, BOCES had six significant lease agreements for space located throughout Broome and Tioga Counties for instructional and non-instructional support services. Two of the leases are with districts for use of some of their building space. The other four lease agreements are with three separate limited liability companies (LLC) and involve leasing entire buildings.[1]

The Chief Operating Officer and other administrative staff members are responsible for negotiating the terms and conditions of the various lease agreements. The lease agreements include terms ranging from one to 20 years and provide, in some instances, that BOCES make annual payments to cover items such as utilities and maintenance costs. BOCES' 2015-16 capital budget appropriations[2] for leased building space are $1.3 million, which are funded solely through charges to the districts.

Objective

The objective of our audit was to examine BOCES officials' process for leasing real property used to facilitate BOCES' off-campus operations. Our audit addressed the following related question:

- Did BOCES officials perform a comprehensive analysis when leasing properties?

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1 It is our understanding that all three LLCs have the same members.

2 Another part of the capital budget is for renting classrooms at various schools in the districts.

Scope and Methodology

We examined BOCES' real property leasing process for the period July 1, 2014 through September 22, 2015. To evaluate potential cost savings, we expanded our scope period to include the 2001-02 through 2034-35 fiscal years to review prior and future costs associated with the properties under lease as of September 2015.

We conducted our audit in accordance with generally accepted government auditing standards (GAGAS). More information on such standards and the methodology used in performing this audit are included in Appendix C of this report.

Comments of BOCES Officials and Corrective Action

The results of our audit and recommendations have been discussed with BOCES officials, and their comments, which appear in Appendix A, have been considered in preparing this report. Except as indicated in Appendix A, BOCES officials generally agreed with our recommendations and indicated they plan to initiate corrective action. Appendix B includes our comments on issues BOCES officials raised in their response.

The Board has the responsibility to initiate corrective action. Pursuant to Section 35 of General Municipal Law and Section 170.12 of the Regulations of the Commissioner of Education, a written corrective action plan (CAP) that addresses the recommendations in this report must be prepared and provided to our office within 90 days, with a copy forwarded to the Commissioner of Education. To the extent practicable, implementation of the CAP should begin by the end of the next fiscal year. For more information on preparing and filing your CAP, please refer to our brochure, *Responding to an OSC Audit Report*, which you received with the draft audit report. The Board should make the CAP available for public review in the BOCES' administration office.

Real Property Leasing

The Board is entrusted with the responsibility of making the best use of BOCES resources and ensuring the districts are well-informed of decisions regarding property acquisitions and leases. Education Law generally provides that a BOCES has authority to rent, improve, alter, equip and furnish suitable land, classrooms, offices or buildings to maintain and conduct cooperative educational services and to serve as administrative offices for a period not to exceed 20 years for leases entered into with non-public entities.

Prior to executing any such lease, the Board must adopt a resolution determining that the agreement is in the districts' best financial interests and stating the basis for that determination. In making that determination, the Board should perform an analysis of the costs and financial benefits of purchasing the property versus leasing it. Performing such a cost-benefit analysis would also provide transparent assurance to the districts' taxpayers that the Board selected the most cost-effective option.

As of September 2015, BOCES had six significant lease agreements with annual costs for 2014-15 totaling about $1.29 million. These leases were for space located throughout Broome and Tioga Counties for instructional and noninstructional support services. Two of the leases totaling $456,300 are with districts for some of their building space and the remaining four totaling $829,300 are with three separate LLCs and involve leasing entire buildings.[3]

Prior to entering into any of the six lease agreements, BOCES officials did not ascertain whether purchasing was an option and, if so, analyze whether purchasing, rather than leasing, was the more cost-effective option. Although the Board adopted resolutions approving each of the leases, none of the resolutions provided a basis for determining that the agreements are in the districts' best financial interests. BOCES officials told us that their analysis for leasing the properties included verifying that the rent cost per square foot for each lease was at or below market asking prices.[4] However, they did not document this analysis for five of the six leased properties.

We reviewed the six lease agreements and confirmed that the rent costs per square foot for each of the properties ranged from $2 to

[3] It is our understanding that all three LLCs have the same members.
[4] The Board must determine that the rental payment is no more than the fair market value.

$12. These costs were at or below the average asking price of $12 per square foot for similar rental property in the greater Binghamton area as of October 2015. However, because BOCES officials did not consider purchasing, rather than leasing, we performed additional analyses for four of the six lease agreements[5] to estimate the costs of purchasing and renovating, if applicable, versus leasing the properties. We generally found that the cost of purchasing and renovating, if applicable, the properties could potentially be less than the rent and property tax payments,[6] if applicable, as detailed below.

- Property 1 – An LLC purchased this property consisting of a 7,800 square foot building and parking lot in February 2001 for $360,000. BOCES began leasing the property in July 2001 to provide a Central Business Office (CBO) function to its districts. As more districts opted to receive the CBO services, BOCES officials determined that additional building space was necessary to handle the increased demand. To address this concern, BOCES officials told us that when the original lease agreement was renewed in July 2005, they negotiated the construction of a second 8,000 square foot building on the property and a corresponding increase in future rent payments.[7] We estimated the cost to construct the second building to be approximately $735,000.

  If BOCES had purchased the property in 2001 for the same price paid by the LLC and constructed the second building in 2005, and if these projects were financed through the issuance of debt, then we estimate the total debt costs to be approximately $2.2 million. By comparison, from fiscal years 2001-02 through 2014-15, BOCES has paid a total of about $2 million in rent. However, the lease agreement was renewed in July 2015 for a term extending through June 2035. Over this 20-year period, BOCES will pay at least[8] an additional $3.6 million in rent, resulting in BOCES potentially paying $5.6 million in total rent

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5 We excluded two of the six properties from the analyses because BOCES rents a portion of each of the two properties. In these instances, purchasing the entire property did not appear to be practical.

6 We could not determine the overall true cost-effectiveness of the various options due to additional factors that we were not able to quantify. For example, our analysis does not account for some costs of ownership, such as the amount of money spent performing repairs to the building.

7 The legal propriety of this arrangement, as well as the arrangements described under the sections Property 2 and Property 3, are outside the scope of this audit.

8 Per the lease agreement, the annual rent for each succeeding year of the term will increase, and can never decrease, by the percentage increase in the average Consumer Price Index (CPI) for the 12-month period ending December 31 of the prior calendar year as determined by the United States Bureau of Labor Statistics. We did not factor in any potential increases in the CPI in our calculation of future rent costs.

over the terms of the lease and all the renewal agreements. Thus, at the end of the current lease term in June 2035, BOCES will have potentially paid $3.4 million more in total rent than the debt costs to finance the purchase and renovation of a property it has no equity in.

- Property 2 – An LLC purchased this property consisting of a 36,000 square foot building in September 2012 for $937,750. BOCES began leasing the property in January 2013. The building was leased to serve as BOCES' duplicating center after the prior location was flooded in September 2011. In the first year of the lease, at BOCES' request, the LLC renovated the building at a cost of approximately $200,000. If BOCES had purchased and renovated the property through the issuance of debt, we estimate the total debt costs would have been $1.73 million. By comparison, during the 10-year lease term from calendar years 2013 through 2022, BOCES will pay $1.68 million in rent and $582,300 in real property taxes,[9] for a total of $2.26 million. Therefore, the debt costs would have been about $530,000 less than what BOCES will pay in rent and real property taxes under the current lease agreement.

- Property 3 – This property consists of a 56,280 square foot building and houses one of BOCES' learning centers. BOCES has been leasing this property since July 1993. From 1993 through 2006, it was owned by one of the districts, and in December 2006 the property was purchased by an LLC for $165,000. From December 2006 through August 2013, BOCES paid about $672,000 in rent. Beginning in 2012, over the course of three years, the LLC renovated the property at an estimated total cost of $2.4 million.

  The most recent lease agreement with the LLC began in September 2013 and extends through August 2023. This new lease gradually increased the rent from about $100,000 a year to $351,000 a year to account for the renovation costs which were being charged to BOCES. If BOCES owned the property and performed the renovations itself, debt costs to renovate the property would have totaled $3.45 million over 10 years versus rent and real property tax payments of $3.49 million for the same time period. This analysis does not include the $672,000 in rent already paid during prior lease terms or the fact that BOCES spent money renovating a property that it has no equity in.

[9] We estimated that future real property taxes would increase annually at a rate of 2 percent.

- Property 4 − This property houses another BOCES learning center. The building is 11,932 square feet and was purchased by an LLC in July 2008 for about $250,000. BOCES began leasing the property the same day it was purchased and the current lease expires in June 2018. BOCES officials did not inform us of any renovations done to this building. From 2008 through June 2015, BOCES has paid $265,000 in rent and real property tax payments.

Because BOCES has not purchased the buildings, it continues to make rent payments[10] with no equity earned. In effect, through its lease payments, BOCES will have spent about $3.4 million in renovations and improvements to properties it does not own.

BOCES officials told us that they prefer to lease property because of the benefits and convenience this option affords them. For example, BOCES officials told us that to purchase a property would require the approval of the qualified voters of each of the 15 districts. Because certain districts do not use the services located at the property, BOCES officials questioned whether the voters in these districts would approve such a purchase. However, when the Board enters into lease agreements, it is not required to obtain voter approval before having the districts fund the rental payments under the leases.

BOCES officials also indicated that, if they owned the buildings, they would be responsible for the up-front funding of the structural repairs and building maintenance. This could prove to be difficult, as a BOCES is not authorized to issue debt for capital purposes, establish capital reserve funds or retain fund balance for expenditure in a subsequent fiscal year. However, BOCES should be able to properly maintain its buildings with adequate financial planning.

BOCES officials further indicated that, if the program or service located in a building is no longer necessary to serve its districts, BOCES' current leases afford it the opportunity to vacate the property with no future obligations. However, because BOCES does not own these buildings, BOCES and its districts are also forgoing a return on their investment if BOCES vacates the property.

Although these are valid considerations in determining whether to lease or buy properties, BOCES officials did not perform a comprehensive financial analysis prior to entering into any of the existing lease agreements to evaluate whether purchasing was a more cost-effective

[10] There is a provision in the lease agreements that, if the programs and services being offered at the location are discontinued, BOCES can terminate the lease agreements.

option. Therefore, we question whether BOCES officials used an adequate process to determine that the lease agreements were in the best financial interest of its districts.

Recommendations

Prior to leasing any real property, the Board should:

1. Perform a comprehensive cost-benefit financial analysis to help ensure the most cost-effective option is selected.

2. Ensure that all Education Law requirements for leasing have been met.

APPENDIX A

RESPONSE FROM BOCES OFFICIALS

The BOCES officials' response to this audit can be found on the following pages.

BROOME•TIOGA
boces
Enriching Lives Through Education
Allen D. Buyck
District Superintendent

435 Glenwood Road, Binghamton, NY 13905-1699
(607) 766-3802 Fax: (607) 763-3691

April 26, 2016

Division of Local Government
and School Accountability
NYS Office of the State Comptroller
110 State Street
Albany, NY 11236

To Whom It May Concern:

Thank you for conducting your audit of the Broome-Tioga BOCES to determine whether in your opinion the BOCES performed a comprehensive analysis when leasing properties. We are in receipt of your draft report. This document should serve as both our response to and acknowledgement of the audit by the Office of the State Comptroller (OSC), as well as, the corrective action plan of the Broome-Delaware-Tioga BOCES to the OSC recommendations.

The comprehensive analyses the BOCES performed when deciding on the leasing of properties included the following:

1. **A market analysis of all prospective properties lease amounts to determine if the prospective lease amounts per square foot were at or below market value for similar properties.** Some of these analytics were documented and compared to other non-BOCES leasehold properties and others were compared to known prices per square foot of the several other properties already leased by the BOCES through Broome and Tioga County.

2. **A comprehensive analysis including conversations internally and with districts to determine if the prospective properties would meet current and future customer/district needs.** The instructional and non-instructional property needs of the BOCES are unique and regulated by the State Education Department for suitability and code. The pool of properties that could meet those needs in Broome and Tioga Counties is very small and in some cases limited to one single available property at the time a property is needed and, therefore, little or no formal documentation exists or was necessary in the analysis process.

3. **An analysis of the economic impact of purchasing a property versus leasing.** If the BOCES owns property that is on the tax rolls there would be a negative impact to taxpayers if the BOCES owns the property as it would come off the tax rolls. Furthermore, in some cases, the BOCES was able to negotiate leases where the landlord is responsible for nearly all exterior and structural components of the buildings and in some cases even interior components such as HVAC. This would negate the necessity of including such costs in operating program budgets. Additionally, since the BOCES is not allowed to create a reserve for capital repair or improvement or acquisitions, this would have to be budgeted for every year and if not spent, returned to the districts in surplus each year. The Comptroller's office has indicated they would like us to continue to find ways to reduce surplus monies to districts.

See Note 1 Page 12

4. **An analysis of participants in programs that would be operated out of prospective properties and the students served by those properties.** In the event a BOCES desires to purchase and own property, it must conduct a referendum to do so whereby all the taxpayers of all 15 component districts would vote to decide whether the BOCES should purchase a property. This is a costly and lengthy process and one which could be decided by taxpayers based on whether their districts even have students from their districts being served by programs in those buildings. Ostensibly, taxpayers would vote no if they have no students in the buildings. Lastly, any capital expenditures to purchase property has a detrimental impact on each district's tax levy limit as BOCES capital expenditures still have no calculable way to be excluded from the tax levy limit calculations of the component school districts.

The BOCES will continue as recommended to perform a comprehensive cost-benefit financial analysis as well as the other types of analyses mentioned above and will strive to formally document all of those analyses and ensure that all Education Law requirements for leasing have been met.

See Note 2 Page 12

Sincerely,

Allen D. Buyck
CEO and District Superintendent
Broome-Tioga BOCES

APPENDIX B

OSC COMMENTS ON BOCES' RESPONSE

Note 1

As stated in our report, BOCES will have spent about $3.4 million in renovations and improvements to properties it does not own.

Note 2

The recommendation in our report suggests BOCES prepare a comprehensive cost-benefit financial analysis. The analysis that BOCES performs, and describes here, does not include any calculations of the costs of buying versus leasing a property to aid in determining that the most cost-effective option is chosen.

APPENDIX C

AUDIT METHODOLOGY AND STANDARDS

The objective of our audit was to examine BOCES' real property leasing process for the period July 1, 2014 through September 22, 2015. To achieve our audit objective and obtain valid evidence, we performed the following procedures:

- We interviewed BOCES officials to gain an understanding of the real property leasing processes used.
- We reviewed the existing lease agreements for each of the six leased properties as of September 2015. We also reviewed Board minutes and resolutions to assess if the Board complied with Education Law prior to entering into the lease agreements.
- We conducted Internet searches of commercial property available for rent in the greater Binghamton area as of October 2015 to assess the average asking price for rent per square foot. We compared this average to the actual rent per square foot BOCES paid on each of the six leased properties during the 2014-15 fiscal year to determine whether the rent payments were reasonable.
- For each of the four properties leased to BOCES by the LLCs as of September 2015, we used a combination of the lease agreements and vendor payment history reports to compile all rent, real property taxes (if applicable) and improvement (if applicable) payments made or expected to be made to the LLCs from the start of the first lease term until the conclusion of the existing lease term. We then obtained the purchase date, price paid by the LLC and the total market value of each property at various dates from the Real Property Tax Divisions of Broome and Tioga Counties. We then contacted a senior financial analyst from the Dormitory Authority of the State of New York and obtained estimated debt principal and interest amounts necessary to finance the purchase and any estimated renovation/construction work, if applicable, as of the start of the existing lease term. We then compared the cost figures associated with the lease agreements to the estimated debt costs and evaluated for potential cost savings. The following are additional assumptions and estimates made by the audit team specific to three of the properties:
    - o Property 1 – We estimated the construction cost for the second building to be $734,808 by subtracting the 2001 purchase price of $360,000 from the 2010 total market value of $1,094,808 when construction was complete. Per the conditions of the second term of the lease agreement, the rent was to be calculated at $5.25 per unfinished square foot and $11.21 per finished square foot. We estimated the conversion rate of unfinished to finished square feet during the building construction to be an equal rate of 25 percent per year such that construction was complete by the end of the second lease term in June 2010.
    - o Property 2 – We estimated the cost of renovations and improvements to the property in the first year of the lease to be $198,000 by subtracting the original agreed upon rent of $118,752 in year two from the agreed upon rent of $316,752 in year one. We also estimated future taxes to increase annually at a rate of 2 percent.

- o <u>Property 3</u> – We estimated the cost of renovations and improvements to the property at the start of the third term of the lease to be $2,425,185 by subtracting the increase in agreed upon rent for the duration of the third term from that of the second term.

We conducted this performance audit in accordance with GAGAS. 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.

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