MINNEAPOLIS PUBLIC SCHOOLS

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Long Range Property Decisions

A white paper on long-term real estate portfolio strategy and decisions on unprogrammed buildings for established urban school districts in Minnesota

Prepared for the Minneapolis Public Schools Board of Education

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Executive Summary

The following white paper outlines the different approaches to long range real estate portfolio management for established urban school district buildings that no longer have active programming, through a specific lens of Minneapolis Public Schools (MPS). This paper does not contain specific guidance or recommendations for action by the School Board of Minneapolis Public Schools, but outlines the different conceptual frameworks for how the organization could approach long term portfolio management decisions for this class of building. Here is a summary matrix of the different approaches:

Option	Cost / Revenue	Timeline	Future Flexibility	Risk Category
Disposition / Sale	Revenue quickly, but it largely goes into paying down existing debt	2-5 years	None	High
Strategic Hold	Expensive to maintain, but avoids potential future acquisition costs	<15 years	High	Medium
Joint Development	Possibly revenue neutral or positive	50+ years	Low	High

Introduction

This white paper is intended to be a high-level summary of the rationale why a school district would determine that a property might be "surplus" (i.e. strategically not needed by the organization to achieve its mission for the foreseeable future) and what strategies it could deploy to manage it after that designation. This white paper does not discuss why a school district might remove all programming out of an existing building nor the steps necessary to close a building per Minnesota Statute §123B.51, but lays out the process essentially from those two actions occurring.

Framework for Determining Property as Surplus

The decision by a school district to remove all of the programming from a building is often one of the most difficult decisions made. For large urban school districts, schools have often been the focal point that neighborhoods have grown around as they have developed, and generations of communities have deep bonds to the history that the buildings contain. While this paper picks the process up after an organization has already made the decision to relocate programming out of a building, we would be remiss if we did not acknowledge the history and sense of loss that may be at the fore for many as a school district contemplates whether or not a particular building has long-term strategic value for the organization.

At its core, planning the future of a building that no longer has programming in it comes to a question of long-term value. It is expensive to hold a property that does not have a programmatic purpose, but it's likely more expensive - both in financial and social capital terms - for a school district to try to reconstitute available buildings and land when needs arise in the future. School district enrollment goes through cycles of growth and decline, and while the future cannot be precisely predicted, the goal is to use the best available data to make as informed a decision as possible.

A core tension in that analysis is that the horizon of the forecast of school district needs is often not as long as the economics of property portfolio management require. Typically, school district enrollment projections only extend for 10 years, as after that timeframe the variables become too significant to make information reliable, but as you'll see later in this paper that is frequently not a sufficient timeframe for the economics of a real estate transaction to dictate the prudence of either holding or disposing of a property. In addition, the school district must contemplate factors, both internal and external, that could alter strategic needs:

- Housing and demographic pattern shifts that could vary significantly across the boundaries of the school district
- Educational marketplace competition and swings in the patterns of family choice

- Plausible expansions of funded programs, such as increases in early childhood or PreKindergarten programming at the state or federal level
- Educational model changes that have spatial implications, such as class size changes or access to specialized learning spaces (e.g. career and technical education spaces, integrated specialized learning opportunities, magnet options, etc).

While there is no single metric that synthesizes all of the above into a declaratory course of action, each must be considered on balance with the overarching financial and operational position of the school district. With that review, the following models of managing a property offer paths forward:

- **Disposition / Sale**: The property is declared surplus, sold, and is permanently removed from the school district's property portfolio.
    - Position: The school district does not believe there is a plausible programmatic need for the property in the next twenty years.
- **Strategic Hold**: The property sits vacant or has minimal use for a period of years until new programming is identified, with the school district expending resources to maintain the building and grounds in order to preserve the opportunity to reuse them in future.
    - Position: The school district believes there is a plausible programmatic need for the property in the foreseeable future and is willing to incur the costs of maintaining the property in order to prevent the cost of acquiring a new property when that future use becomes necessary. This model is also prudent for school district strategic needs around resilience planning in order to ensure continuity of operations should catastrophe befall one or several other district properties.
- **Joint Development**: The property is declared surplus and developed into a new use, with the school district maintaining interest or control of the property in some manner in order to preserve the opportunity to revert it back to a school district purpose at some point in the distant future.
    - Position: The school district believes that the property has strategic value long term, but the timeframe for that need is potentially decades in the future and there may be a way to have the property fulfill another need for

the community while also mitigating the carrying costs of the property over that period of time.

Models of Management

Disposition / Sale

Most school districts have Board-level policy on the disposition of district property, which in Minneapolis is Policy 3270 - Sales and Leases of Real Property, and its attendant regulation. As that policy and regulation are fairly explicit in the steps required to sell a district property the process won't be elaborated on significantly in this paper. It is prudent to remember that bringing a property to market is a significant endeavor, and the solicitation, review, selection, and execution of a Purchase Agreement can also be a multi-year endeavor. Depending on market conditions, buyer interest, and school district directives, it is prudent to assume that the sale of a school property will take at least two years and potentially significantly longer.

As for what happens with the revenue the school district is able to collect in the sale of the property, Minnesota Statute §123B.51, Subdivision 6 is very prescriptive about the ways that it is applied. For Minneapolis Public Schools, in almost all foreseeable circumstances the revenue from the sale of real property would be applied to existing school district debt. This would have the direct benefit of reducing the amount of debt service the district has to pay each year, but it would not be able to fund more immediate, tangible needs such as hiring additional teachers or staff.

Strategic Hold

If a property meets several strategic criteria it may be in a school district's best interest to hold onto the property for a reasonable period of time. Examples of the types of strategic factors that would indicate this is the appropriate action include:

- It is anticipated that changes to regional housing or school choice patterns might give rise to an increase in potential students such that additional enrollment capacity would be necessary.
- The building and site area are sufficient to plausibly meet the needs of a future use (i.e. not too small)
- There is an articulable future academic program that may align with what the site can support.
- The school district has determined that it has a strategic need for continuity of operations planning should catastrophe befall one or several other district properties.

In developed urban cities like Minneapolis, the relative scarcity of available parcels of land to build future needs is a primary reason why the strategic holding of properties is prudent for a school district. Additionally, factors such as the current real estate market conditions in order to achieve an appropriate value, the possible use of surplus school buildings by competing interests that may impede the mission of the school district, and the possibility of an equivalent property becoming available in the future should all be considered.

Though a difficult topic, it is prudent that school districts have some strategic flexibility in order to ensure continuity of operations should any number of issues arise. In the Twin Cities, one need not look farther than the tragic explosion at Minnehaha Academy in 2017 or the fact that Minneapolis averages approximately one tornado every decade to understand why having a building (or several, given the scale of an urban school district) available to rapidly shift programming to in case of an emergency is prudent. There may also be non-emergency uses for such a building which could greatly benefit the school district, such as relocating a program during a major construction project in order to expedite the work and reduce its overall cost.

One of the most challenging questions when determining if a property is worth holding on to for longer term strategic flexibility is the question of "how long." As will be discussed shortly, it is very expensive for school districts to maintain and hold unprogrammed property, but the primary purpose of holding a property is to avoid the cost of future land acquisition and construction (if possible at all) when the need arises again. Though there are many variables that go into determining when the cost of holding a building becomes more than the cost of acquiring new, it is a reasonable position to assume that any duration beyond 20 years for a building to be unprogrammed likely means that an alternate management approach for the building (such as sale) might be more prudent. Additionally, any duration of time longer than that makes the confidence that the existing structure will align with the future need of the district that much less.

Even though a school district building / site may not have any active programming in it, the school district still has to maintain the building and site in accordance with local ordinances (such as groundscare and snow removal) as well as to preserve the value of the asset and its readiness to serve a future purpose. While the temperature set point certainly can be adjusted lower when not occupied, consistent heat and ventilation are critical to ensure asset preservation and deter the growth of mold. Signs of disrepair - broken windows, graffiti, etc - can invite even greater vandalism if not addressed quickly. Based on a review of Minneapolis Public Schools' currently vacant properties, the cost of holding a property per year is broken down per square foot as follows:

	Utilities	Snow / Grounds	Maintenance & Operations	**Total**
Approx. Cost / SqFt	$0.85 - $1.10	$0.07 - $0.11	$0.30 - $0.85	**$1.22 - $2.06**

This roughly equates to the following annual carrying cost per property type:

- A small elementary school (± 40,000 Sq Ft): $50,000 - $80,000
- A medium middle school (± 125,000 Sq Ft): $152,000 - $260,000
- A large comprehensive high school (± 275,000 Sq Ft): $325,000 - $565,000

In order to defray these costs, it is prudent to explore two different strategies: leasing and selective demolition. Leasing a property may be an effective way for a building to see continued use while also covering (in whole or in part) the costs of owning and operating it. MPS Regulation 3270A - Disposition of Surplus Property defines many of the steps for the school district to identify a viable lease arrangement, but the key financial variable is of the intended use and the rental real estate market. As of the writing of this report, the relative softness of the Twin Cities rental market for many commercial, educational, and institutional markets stemming from the lingering effects of the COVID-19 pandemic likely mean that revenue generated from a lease may not fully cover the operating costs of the building itself. Additionally, school districts that issue certain types of bonds, including Minneapolis Public Schools, have limitations around the amount of lease revenue they are able to collect on a building in which those bonds were issued for. The calculation of that limit is highly technical and varies for each building, but it is potentially a significant limiting factor when contemplating leasing an unprogrammed building.

Selective demolition - the razing of the entirety or portions of a building - may be deployed judiciously to control the operating costs of an unprogrammed building in certain, very limited, circumstances. If the condition or function of the existing building is already highly compromised, there may be a reasonable return on investment to spend the money to demolish a building up front and spare the annual costs of heating and maintenance. Though demolition costs are highly variable based on the specifics of a site, a reasonable ballpark to demolish a school building in the Twin Cities is $500,000 for a small elementary school and $2,000,000 for a large high school.

Joint Development

If the property in question likely has long-term strategic value (see the litany of reasons why this might be in the "Strategic Hold" section), but the time horizon is extremely extended, the holding costs are untenable, and there is a valuable non-school-district purpose the building could serve for the community, a paradigm in which the school district maintains a long-term real interest in the property while partnering with another organization to develop a different use for a predetermined period of time may be prudent. This is not a common practice for school districts, historically, but it may become more so as American cities continue to develop.

Minnesota school districts may enter into several different types of joint agreements to facilitate a Joint Development of a school district property:

1. A ground lease with a developer, the City, or an Housing and Redevelopment Authority (HRA)

2. Utilize a joint powers agreement with another governmental agency (City, HRA, etc) to establish a Community Land Trust (CLT) that holds leases on surplus properties.

In both structures, the school district would need to have covenants in place to ensure the use does not interfere with the school district's educational programming, set a timeframe or other conditions to return the property to the school district's sole usage (50-99 years, or breach of contract), and otherwise ensure the rights of the school district were clear and in alignment with state law and school district policy. In Minneapolis, the existing Stable Homes, Stable Schools program between MPS and the City of Minneapolis may provide a clear example of how the potential for affordable housing in such an arrangement may be of mutual benefit between governmental agencies.

Option Not Available

There are many active conversations across the country about school districts forming a housing development authority under the umbrella of the school district or otherwise becoming the direct developers of housing on school district properties. In Minnesota, school districts are political subdivisions that are limited to the powers expressly delegated to them by the state legislature. Similarly, in Minnesota the power to establish a Housing and Redevelopment Authority (HRA) is limited to cities and counties. Therefore, a school district would not be able to form an HRA because it is neither an express power nor a necessary implied power of a school district. To achieve a similar impact, a school district in Minnesota would have to pursue a Joint Development model as described above.

Conclusion

With roots in the Baby Boom from the mid-1940s to the mid-1960s, public school systems are always in some stage of the natural ebb and flow of birth rates and, correspondingly, enrollment. As a school district's property portfolio becomes misaligned with its current needs, it is important to develop a long-term property portfolio management strategy that best balances the short- and long-term risks and rewards. This white paper has detailed the three viable strategies for a school district in Minnesota to approach a school building that no longer has any programming in it, each with a different cost / benefit and time horizon. Invariably, school districts are well-served to consider all three different approaches in the long-range management of their portfolio of properties.

References:

Minnesota Statute §123B.51
Minnesota Statute §462A.31
Minnesota Statute §469.003
Minnesota Statute §471.59
MN DNR: Minnesota Tornado History and Statistics