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FISCAL IMPACT REPORT

ORIGINAL DATE 09/13/11

SPONSOR Keller and Larrañaga LAST UPDATED 09/23/11 HB _____

SHORT TITLE Procurement Preferences SB 1/aSF1#1

ANALYST Haug/Hanika-Ortiz

REVENUE (dollars in thousands)

		Recurring or Nonrecurring	Fund Affected
FY11	FY12		
\$0.0	\$320.0*	Recurring	General Fund (TRD application fees)

(Parenthesis () Indicate Expenditure Decreases)

* See narrative

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	FY14	4 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		≈\$880.0*	≈\$1,200.0*	≈\$640.0*	≈\$2,720.0*	Nonrecurring	State General Fund
Total		≈\$2,640.0*	≈\$3,600.0*	≈\$1,920.0*	≈\$5,760.0*	Nonrecurring	All other state and local funds (Except State Road Fund and Medicaid)
Total		\$170.0	\$135.0	\$135.0	\$440.0	Recurring	Taxation and Revenue Dept. (General Fund) –certification function

(Parenthesis () Indicate Expenditure Decreases)

*See fiscal impact narrative for discussion of this impact

SOURCES OF INFORMATION

LFC Files

Responses Received From

General Services Department (GSD)

Attorney General (AGO)

Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of SFl Amendment #1

Senate Floor Amendment #1 replaces, throughout the bill, the Taxation and Revenue Department with “the state” as the administering organization for payment of any non property tax qualifying the applicant for issuance of a resident business certificate or a resident contractor certificate.

The Amendment clarifies throughout that any property purchased or leased used to satisfy requirements for the issuance of a resident preference certificate must be real property.

In addition to a previously certified business or contractor that undergoes any of a number of business organizational changes, a business or contractor that “was eligible for certification” undergoing the same changes would also meet the requirements for the affidavit issued by a certified public accountant.

The amendment removes throughout the statement that a previously certified business undergoing a number of business organizational changes, “continues to meet all criteria for a resident business certificate.”

In decisions issued on appeals for denials of a resident preference certificate or in the case of a hearing determining that the applicant provided false information to obtain a certificate or that a resident preference certificate holder did not perform the percentage of the contract specified in the bid or proposal, the amendment would require the Taxation and Revenue Department to inform the appealing party of the reasons for the action taken and inform the appealing party of the right to judicial review of the determination.

Finally, the amendment revises the definition of “relocated business” to mean one that moved eighty percent of its total domestic personnel rather than eighty percent of its domestic business operations to New Mexico in the past five years.

Synopsis of Original Bill

Senate Bill 1, with the emergency clause, modifies the states procurement code preference for resident businesses and resident contractors, limiting the contractor and non-contractor businesses eligible for the preference to those who meet more stringent requirements for duration and scope of business activity in New Mexico.

With the following listed exceptions, Senate Bill 1 is substantively identical to Senate Bill 19 passed in the 2011 Regular Session and vetoed by the Governor:

- 1) Removes “for profit” in the definition of business – p2, line 4
- 2) Adds definitions for formal bid process and formal request for proposals process in both the contractor and non-contractor sections of the bill – p2 lines 5-9
- 3) Substantially changes the definition of “public body”, limiting the application of the bill while specifying entities subject to its provisions – p2 lines 10 - 18
- 4) Changes from 5 years to 3 years the length of time for the affidavit requirement of one other TRD administered tax being paid – p12 line 25 and p13 line 6
- 5) Replaces throughout the term “entrepreneur” with “new business”

- 6) Substantially expands the scope of changes permissible for “a previously certified business” to retain eligibility for a resident business certificate – p13, lines 17 – 24
- 7) “Legacy contractor” is defined on p.17, lines 19-21 as a “construction business that has been licensed in this state for ten consecutive years.” Previously, the definition was “owned by a resident” rather than licensed.
- 8) Provides for deemed approval of the application for resident certification if TRD has not notified the applicant within 30 days of disapproval. P15, line 25 – p16, line 2
- 9) Changes the definition of a relocated contractor business to a business “that moved eighty percent of its domestic business operations from another state to New Mexico in the past 5 years” p17 – lines 22 – 24. The definition previously referenced “principal place of business instead of the revised criteria.

FISCAL IMPLICATIONS

The TRD states:

Although the bill contains a fee to cover the administrative costs to TRD, the revenue from the fee is not appropriated to TRD. According to India Garcia of the State Purchasing Division, it takes them 2.0 fte to annually process several hundred new applications of this nature. The State Purchasing Division has approximately 10,000 current certifications all of which may require re-certification effective January 1, 2012. In addition, an unknown increase in certifications will be attributable to a separate contracting process with local governments.

IT would develop a system to assess, track and process the fees and penalty payments. This would be a new tax program in Gentax for IT to design. Develop coordination with other agencies, including Department of Workforce Solutions, Worker’s Compensation Administration, 33 county assessor’s offices, Regulation and Licensing Department. Create forms and instructions including changes to the web site. Create regulations to clarify the statute. The costs associated with implementing the changes are magnified because of the effective date.

The TRD estimates are used for TRD potential impacts in the additional operating budget impacts table above.

Please see the attachment to this FIR for a more detailed description of the methodology used to derive the specific table numbers above.

It is important to note that there is an existing procurement preference for businesses that meet the current requirements for application of the preference. Therefore, the fiscal implications of Senate Bill 1 should revolve around the marginal difference between the costs of the existing preference and the revised preference as expressed in the bill. There is no data available that reliably reports the costs of the existing preference. Consequently, no reasonable method to compare the relative costs of the two approaches is possible.

For the revenue table above, it is assumed that 6,400 contractors would apply to TRD initially for certification and that TRD would set the application fee at \$5. After the initial rush, the steady state workload would average 3,200 certifications a year. These fees are not appropriated to TRD, so the fee collections would be transferred to the general fund as miscellaneous revenue.

The tables above are reduced approximately 20% from the analysis accompanying Senate Bill 19 in the regular session because of the more limited applicability of the definition of public body in Senate Bill 1. The tables attempt to quantify possible costs associated with the adoption of a new approach to application of the preference. Please note that these costs are estimates, predicated on a particular set of assumptions, detailed in the attachment to this FIR. Other assumptions regarding the application of the changes proposed in Senate Bill 1 are certainly possible and could result in estimates of costs that are either lower or higher than those reflected in the tables of page 1 of the FIR.

The biggest change from this bill will be in restricting brokering (see Significant Issues) and ensuring that New Mexico workers benefit from the resident preference. Although there may be a very short term increase in costs to state and local agencies, within, at most, three years, increased competition will move prices back down to traditional levels, brokers will not receive windfall profits and more New Mexican workers will have permanent jobs.

SIGNIFICANT ISSUES

The purpose of this bill is to prevent abuse of the current resident preference provisions and provide a meaningful but validated system of preference in purchasing for legitimate New Mexico resident businesses. One of the abuses noted in the current procedure is “brokering.” A true resident business or contractor – with a principal place of business in the state, five resident employees and a history of paying tax in the state – makes an arrangement with an out-of-state contractor to take advantage of the “affiliate” provision of current law. The broker may not actually participate in the project awarded, but does qualify the joint proposal for resident treatment.

The AGO notes:

By the terms of the bill, a business or contractor whose application for certification is denied by the Department is entitled to only a review by the Department. There is no hearing process and judicial review is not mentioned. An aggrieved entity may attempt to challenge this on the grounds that it is not sufficient due process.

The bill provides a 5% bidding advantage for “recycled content goods” but does not provide any mechanism for certification or a check on whether the goods actually are recycled, which may lead to more procurement protests.

The bill provides that when a bid is submitted jointly by a resident and nonresident business, the preference percentage shall be reduced in proportion to the percentage of the contract performed by the nonresident business. In practice however, it is sometimes very difficult or impossible to accurately determine exactly what proportion of the contract is performed by one party as opposed to the other. This provision is therefore likely to lead to more procurement protests.

The TRD states:

It makes sense to move responsibility for verifying residency from the General Services Department to the Taxation and Revenue Department because tax return information is very useful for this purpose and that information is usually protected by confidentiality statutes. The challenge will be adapting to a new set of responsibilities, devising an appropriate set of appeal and review procedures, etc., which are not related to the Department’s core function of collecting revenue.

TECHNICAL ISSUES

The TRD suggests:

Page 12, lines 19 & 20, - the Department should also be allowed to accept an affidavit from an attorney. (Same comment for Page 14, lines 1-2).

Page 12, lines 22-25, - “at least on other tax” should be changed to refer explicitly to the gross receipts tax, withholding tax, or compensating tax, which are tied to physical presence. (Same comment for page 13, lines 4-6; page 14 lines 10 and 18).

Page 15, lines 23-25 – “Within thirty days” is not clear if it is from the receipt of the application or from when all necessary documentation for review is received.

Page 17, lines 10-11, - It will be difficult for the State Auditor to review the issuance or validity of the certificates because the Department is not allowed to share tax records with them.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Procurement and contracting between private businesses and the state and local governments will be subject to the same rules and procedures as at present.

GH:AHO/svb

Attachment to Senate Bill 1 FIR

Procedural Mechanics of Certificate Issuance

The new multi-step process follows: (a) a prospective resident contractor or business obtains an affidavit from a certified public accountant that the contractor or business meets specific requirements; (b) based on the affidavit from a CPA, the bill requires the Taxation and Revenue Department to issue a contractor or business certificate for the prospective contractor to include with bid documents; and (c) based on the certification as a resident contractor or resident business, the state agency or local government entity is then required to implement a 5% price preference for the resident contractor or business. If a resident business or contractor is in partnership or other joint arrangement with a non-resident business or contractor, then the 5% preference is ratioed by the anticipated participation of the dollar value of the goods or services to be provided by resident business and non-resident business. This feature will restrict “brokering,” where the non-resident business or contractor provides the vast majority of the goods and services, but the relationship with the resident broker invokes the full 5% preference in current law.

The Taxation and Revenue Department has 30 days in which to act on the application for certification. The certificate is valid for three years. Aggrieved or denied applicants may schedule a hearing with TRD and present evidence. If TRD finds that a business or contractor applicant has presented false information, or if TRD determines that an applicant has misused a certificate in various ways, then the business or contractor’s certificate may be revoked for a period of five years and TRD may assess an administrative penalty of \$50,000. TRD may cover its costs of administration of the certificate system with a fee, but the fee is not appropriated to the Department.

The bill defines a “relocated business” and defines the specific requirements for certification – approximately equivalent to the main requirements. A “relocated business” for example, would qualify for preference if 80% of the employees of the business the year before the submission of the affidavit were residents of New Mexico and that the business had leased property in the state for ten years or purchased property in the state greater than \$100,000 in value.

The bill strikes language which previously allowed New York businesses to be considered “resident businesses” and modifies the procedures for evaluating a proposal or bid. The bill, however, retains the 5% preference for the purchase of recycled goods, although provides that only one 5% preference applies.

The bill retains the provision of current law and declares that the preference does not apply if the procurement or project is funded at least partially with federal funds. Another important modification of current policy is that the preference will apply to contracts larger than \$5 million.

The bill clarifies that if a joint bid is submitted by both resident and nonresident businesses, the preference is reduced in proportion to the percentage of the contract that will be performed by the nonresident business.

Fiscal Table Methodology

In the past, this bill carried an “indeterminate” operating budget fiscal impact. The LFC is making a considerable effort to quantify revenue, appropriation and operating budget impacts.

Total procurement (excepting procurement funded with federal money) by state agencies exceeds \$1.7 billion – roughly \$1.0 billion in personal services, \$500 million in GO and STB capital outlay (average) and \$200 million in supplies, materials, furniture and fixtures. Over \$300 million in federal highway funding and over \$1 billion in federal Medicaid funding would be exempt from the resident bid preference provisions. A careful detailing of the 2010 General Appropriations Act and the Feed Bill shows the following:

Contracts Line	General Fund	OSF/IFT	Excluding sole source contracts	
			General Fund	OSF/IFT
	\$251,968.2	\$850,147.3	\$249,729.3	\$848,245.0

Approximately, then, \$350 million general fund is the competitive base of this bill \$250 million in personal services contracts and \$100 million in procurement of supplies, materials, furniture and fixtures. This estimate excludes roughly \$2 million in sole source contracts. Industry sources estimate that approximately 40% of state contracts and procurement is awarded to true resident contractors and businesses. Most of the remaining 60% is currently awarded to out-of-state businesses and contractors who can easily qualify for technical residency pursuant to current statute.

Potentially, the cost of this bill to the state could be as much as \$11 million, assuming that the bid cost of all contracts and procurement would increase by the full 5% of the in-state preference. ($\$350 \times 60\% \times 5\%$). Under the terms of the bill, it will be relatively easy for an out-of-state business to qualify and certify as a resident business or contractor, but the resulting firm must employ residents, at least 80% of the total crew. In general, if bidders submit proposals in excess of the amount appropriated for the project or procurement, then the winning bidder can negotiate quantities or other issues in order to bring the final bid under the amount appropriated. Because of this strong limit, the major effect of this bill will be to direct contracts to true in state businesses or contractors. In the short run, we estimate that the price increase will be 1/5th of the full 5% in-state preference. This puts the initial increase in general fund costs at \$2.2 million for the full year and \$1.1 million for the initial half year. Second full year costs to general fund agencies would be about \$1.5 million and third full year costs less than \$1 million. Local government operating costs and capital outlay costs would also increase commensurately in the short term.

Initially, and for several years in the future, true resident contractors and businesses would have an advantage, and this advantage would slightly increase costs to the agencies. Eventually, economics would prevail and more efficient producers would qualify as resident businesses and the state and local governments would then receive competitive prices. This is shown in the table as a declining cost to the agencies.

Offsetting this temporary increase in agency costs, there would be an increase in revenues, particularly Gross Receipts tax, and, to a lesser extent, Corporate Income Tax, Personal Income Tax and Motor Vehicle Excise Tax. The general fund increase would be on the order of 5% of

increased costs and other state funds and local funds increase would be on the order of 4%. On a \$2.5 million base, this would be \$120 thousand general fund and \$100 thousand OSF and local funds. There might also be slight decrease in unemployment costs as more New Mexicans were hired for public works projects.

For the purpose of this estimate, it is assumed that 8,000 contractors would apply to TRD initially for certification and that TRD would set the application fee at \$5. After the initial rush, the steady state workload would average 4,000 certifications a year. These fees are not appropriated to TRD, so the fee collections would be transferred to the general fund as miscellaneous revenue.