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FISCAL IMPACT REPORT

ORIGINAL DATE 2/16/11

SPONSOR Chavez, D. LAST UPDATED _____ HB 309

SHORT TITLE Procurement Code Procedures to Certain Leases SB _____

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
	NFI	NFI	NA	NA

(Parenthesis () Indicate Revenue Decreases)

Duplicates, Relates to, Conflicts with, Companion to SB 19

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	FY14	4 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		≈\$5,200.0*	≈\$5,200.0*	≈\$5,200.0*	≈\$15,600.0*	Recurring	State General Fund
		≈\$10,400.0*	≈\$10,400.0*	≈\$10,400.0*	≈\$31,200.0*	Recurring	All other state and local funds (Except State Road Fund and Medicaid)
		\$5,000.0	\$0.0	\$0.0	\$5,000.0	Non-recurring	All funds; all agencies – recompeteing contracts and leases
		\$500.0	\$225.0	\$225.0	\$1,200.0	Recurring	GSD – PCD and SPurchasing Office (General Fund) to develop and maintain lease price database

(Parenthesis () Indicate Expenditure Decreases)

See Fiscal Implications for discussion of the methodology leading to these estimates.

SOURCES OF INFORMATION

LFC Files

Responses Received From

Office of State Auditor (OSA)

New Mexico Environment Department (NMED)

General Services Department (GSD)

Attorney General's Office (AGO)

New Mexico Corrections Department (NMCD)

SUMMARY

Synopsis of Bill

House Bill 309 proposes a number of changes to the State's Procurement Code. These are listed in detail in "Significant Features" section of this FIR. Two proposed changes seek to address and remediate any residue of past "pay to play" in state and local procurement:

- Requires all public entity lease contracts be terminated after July 1, 2011, unless a waiver has been granted by the governor or head of public entity not under control of the governor.
- Requires all public entity procurement contracts to be terminated after July 1, 2011, unless a waiver has been granted by the governor or head of public entity not under control of the governor.

Four other features of the bill ensure that "pay to play" will never again be part of state procurement:

- Requires additional information be added to the state contracts database including invitations to bid and requests for proposals, awards made by state agencies, sole source contracts by state agencies, agency records of sole source and emergency procurements, and results of annual audits of construction contracts.
- Amends 13-1-126 Sole Source Procurement, adding approval by the governor for state agencies to enter a sole source contract, and by the administrative head of agencies or local public bodies not under control of the governor.
- Adds a new section to the procurement code requiring the Department of Finance and Administration to annually audit or cause to be audited each contract for construction over \$5 million.
- Adds a new section to the procurement code regarding real property leases, requiring the Property Control Division (PCD) review and certify that the lease price is less than 125% of the average lease price paid for similar property under similar terms in the same area. PCD is also required to maintain a database of lease prices paid throughout the state.

Finally, the bill substantially revises the details of the resident procurement preference:

- Defines a "resident veteran contractor" and adds a 15% resident veteran contractor preference;
- Doubles the resident business procurement preference to 10%;
- Eliminates the 5% preference for resident manufacturer;
- Eliminates the 5% preference for recycled goods.

FISCAL IMPLICATIONS

Last year, this type of bill would have carried an "indeterminate" operating budget, revenue and

appropriations fiscal impacts. This year, LFC is making a considerable effort to quantify revenue, appropriation and operating budget impacts. This quantification may require adopting new, somewhat untested methods. Quantifying the fiscal impact of this bill is a clear example of this approach. Since this bill amends the state procurement code as does SB 19, a similar methodology for the op bud impact will be adopted.

Total procurement, excepting procurement funded with federal money, by state agencies exceeds \$2 billion -- approximately \$400 million from the general fund for contracts valued at under \$5 million. 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. Note that over \$250 million in federal highway funding and over \$1 billion in Medicaid funding would be exempt from the resident bid preference provisions.

Potentially, the cost of this bill to the general fund could be as much as \$52 million, assuming that the bid cost of all contracts and procurement would increase by the full differential between no preference and 10% or 15% of the resident business or resident veteran's preference. ($\$400 \times 60\% \times 15\% + \$400 \times 40\% \times 10\%$). Under the terms of the bill, it will be very easy for an out-of-state business to qualify and certify as a resident business or resident veteran's business. In fact, in-state firms will have to set up subsidiaries and affiliates that can qualify for the 15% veterans preference in order to compete against brokers who will reorganize to take advantage of the new resident veteran's preference.

It is likely that with the new preferences stimulating the growth of resident veteran's preference brokers, that the 60%/40% split currently reported will persist forever. The average increase in price to state general fund agencies will then be the full amount of the \$52 million calculated above. Resident businesses have a relative advantage of lower personnel, overhead and temporary costs; non-resident affiliates have the advantage of access to capital and equipment and economies of scale.

Local government operating costs and state capital outlay costs would also increase commensurately and would be permanent. On a base exceeding \$2.5 billion, a 10% increase in cost attributable to the new and increased preferences could approach \$250 million.

Most state projects are limited to the level of appropriated funds. If bids exceed the amount appropriated, then the project is rebid or cancelled. The estimates of cost increases attributable to the action of the preference clearly puts agencies into that realm. The numbers reported in the table above are chosen to indicate that there will be cost increases for the state agencies, but because of budget limitations, the net additional cost will only be approximately 10% of the unlimited effect.

Unlike the changes in SB 19, prices will not move back down to traditional levels after three years. Also unlike SB 19, there will be only a very modest increase in resident employment with the proliferation of veteran's preference brokers. This will generate an equally modest increase in personal income tax.

Somewhat 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 \$52 million base, this would be \$2,500.0 general fund and \$2,000.0 local funds. If the \$250 million local and OSF cost increase occurred, the increase in general fund revenue would be \$12.5 million and \$10.0 million local government revenue. Because of the very modest increase in resident employment, there would be no change in unemployment costs. Because fewer contracts would be issued since each project would cost 10% more than at present, the end result might be job losses.

The cost of cancelling all procurement contracts and all state leases on July 1, 2011 will be large – not only for the state and local government entities, but for the vendors and offerors. There is little question that all state contracts – and probably most local contracts – have a no-cost cancellation feature in the contract boilerplate. “Either party may cancel the contract with 30 days notice.” However, there may be unintended consequences of these cancellations. Consider businesses that expanded, borrowed money, built facilities or purchased equipment using the state contract as collateral. Cancelling the contracts may well mean that a significant portion of the businesses that negotiated their contracts in good faith will be forced into bankruptcy.

The effect of recompeteing all state contracts and leases would be to shut down state – and probably local -- government for at least three months. The Governor would probably use the authority granted in the bill to waive recompetition of most state contracts – focusing on recompeting contracts in problem areas such as investment counsel or construction. The cost of recompetition is shown in the op bud table as a \$5 million placeholder.

GSD/PCD reports that state agencies have in place over 400 leases valued at over \$47 million annually. PCD estimates that the lease review required in this bill will double the required permanent staff and require additional temporary assistance to recompetete all 400 state level shortly after the July 1, 2011 cancellation date.

The Contracts Review bureau at DFA and the State Purchasing Agent would require additional temporary staff assistance to recompetete even a small fraction of all state contracts and leases within a reasonable time after the July 1, 2011 cancellation date.

SIGNIFICANT LEGAL ISSUES

The AGO notes the state’s and local governments’ potential liability for early termination of leases and contracts:

Sections 13 and 14 of House Bill 309, relating to existing contracts, raises concerns about the state’s potential liability for early termination of the contracts, unless the contracts by their terms allow for unilateral termination by the state.

DFA’s standard personal services contract provides for cancellation by either party with 30-day notification to the counter-party. If state and local government agencies have consistently used DFA’s standard boilerplate, then this warning may be moot. However, any contracts that don’t have a unilateral cancellation clause could cause a problem

SIGNIFICANT ISSUES

The bill changes the procurement code in many ways. The title accurately expresses the

significant features. The annotated title follows:

- Relating to government contracting;
- Applying procurement code procedures to certain leases of real property;
- Providing for a ceiling on lease payments;
- Increasing the bid preference for resident businesses (to 10%);
- Creating a 15% bid preference for New Mexico veterans (majority ownership of the business by an honorably discharged a veteran);
- Providing additional requirements for sole source contracts;
- Providing for additional (contract) information to be posted on the internet;
- Requiring annual audits of construction contracts;
- Prohibiting public money from being expended after June 30, 2012 pursuant to a lease or procurement contract, unless the contract was entered into pursuant to law on or after July 1, 2011;
- Providing for temporary waivers from the prohibition;
- Reconciling conflicting amendments to the same section of law in Laws 2001 by repealing Laws 2001, chapter 293, section 1.

Several other features in the bill are not referenced in the title:

- Eliminates the 5% preference for recycled content goods;
- Eliminates an historical reciprocal residence preference with New York State;
- Retains the preference exclusion of projects funded all or in part with federal funds;
- Retains the applicability of the resident and veteran's preferences to contracts valued under \$5 million;
- Retains the qualifications and application procedures for resident preference certification.
- Eliminates the resident manufacturer preference.

The State Purchasing Agent (GSD/SPA) expands on these categories, as follows:

- 13-1-21 NMSA 1978 Application of Preferences is amended to remove New York state businesses from the preference list; to increase the resident bidder preference from 5% to 10%; and to add a new preference for “resident veteran business” of 15%.
- Amends 13-1-97.1 Contract Database to add additional information to the state contracts database including invitations to bid and requests for proposals, awards made by state agencies, sole source contracts by state agencies, agency records of sole source and emergency procurements, and results of annual audits of construction contracts.
- Amends 13-1-126 Sole Source Procurement, adding approval by the governor for state agencies to enter a sole source contract, and by the administrative head of agencies or local public bodies not under control of the governor.
- Adds a new section to the procurement code requiring the Department of Finance and Administration to annually audit or cause to be audited each contract for construction over \$5 million. A number of audit determinations are required:
 - Contract specifications followed
 - Contract award procedures follow law
 - If contractor and subcontractors are “adequately” performing the work
 - If contractor and subcontractors met time requirements
 - If the state agency or local public body adequately administered the contract
 - If state agency or local public body recovered funds from cost overruns and penalties
 - Requires the results of the audits to be posted on the state contract database, and on

- the web site of local public bodies
- Adds a new section to the procurement code regarding real property leases:
 - All public entities seeking to lease real property from private persons shall comply with this new section
 - Public entities shall submit lease contracts to the Property Control Division (PCD) of the General Services Department (GSD) for review and to determine if the lease price is less than 125% of the average price paid for similar property under similar terms in the same area. PCD is also required to maintain a database of lease prices paid throughout the state.
 - Directs public entities, if PCD determines that a proposed lease price is more than 125% of the average price, to do the following:
 - Negotiate a price less than 125% of the average with the proposed lessor
 - Failing the above negotiation, negotiate with other responsible offerors a price less than 125% of the average
 - Failing the above, cancel and reissue the request for proposal
 - No lease shall exceed 20 years
 - Excepts lease-purchase from this section of statute
 - Defines “public entity” as “the state or any of its officers, branches, agencies, institutions, instrumentalities, or political subdivisions.”
- Amends 13-4-2 Resident Contractor Defined to add the definition of “resident veteran contractor” and to add resident veteran contractor to the procedures by the state purchasing agent for determining preference.
- Amends 15-3B-4, PCD enabling statute to add a new duty to maintain a database of lease prices throughout the state and to make lease determinations required by the new “Real Property Lease” section proposed to be added to the procurement code.
- Establishes a temporary provision requiring all public entity lease contracts to be terminated after July 1, 2011, unless a waiver has been granted by the governor or head of public entity not under control of the governor.
- Establishes a temporary provision requiring all public entity procurement contracts to be terminated after July 1, 2011, unless a waiver has been granted by the governor or head of public entity not under control of the governor.

PERFORMANCE IMPLICATIONS

Cancelling all contracts and leases on July 1, 2011 would shut down state – and probably local – government for up to three months as contracts and leases were recompeted. The Governor would probably sign waivers of cancellation for most agencies, requiring recompetition for only the most egregious contracts or leases. The performance implications for the agencies required to compete a modest portion of their contracts and leases would be significant. Many other performance goals would suffer as all agency personnel were drafted to prepare RFPs and analyze bids and select successful bidders.

ADMINISTRATIVE IMPLICATIONS

See discussion at “Performance Implications”

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB 19 amends the procurement code to change resident preference qualifications. The purpose of SB 19 is to restrict “brokering” and implement a true resident preference. The purpose of HB 309 is to eliminate any possibility of “pay-to-play” in current contracts and leases and to extend that promise to future contracts and leases. It might be useful to combine the reforms suggested in SB-19 with the reforms proposed in this bill.

HB 309 also relates to HB 128, which proposes new procedures for making sole source procurements. Unlike HB 309, however, HB 128 does not require the Governor’s approval of sole source procurements.

TECHNICAL ISSUES

NMED suggests restoring the recycled materials preference. This preference in state and local procurement has been an important element in the development of a recycling industry in the state.

OTHER SUBSTANTIVE ISSUES

This bill does not reform “brokering,” whereby a small brokering firm, which qualifies for a resident preference, affiliates with a large out-of-state firm that does the actual work required in the contract. All the in-state broker must do is maintain a principal headquarters and hire at least five New Mexico residents. The large out-of-state firm can establish a wholly (or partially) owned subsidiary in a small “headquarters” office and qualify for the 5% resident preference on all contracts less than \$5 million in value.

NMCD suggests that cancelling and recompeting contracts regarding private prisons and leases for specially equipped probation and parole offices might have an adverse effect on public safety.

ALTERNATIVES/POSSIBLE AMENDMENTS

Because of possible adverse effects on public safety, exclude contracts and leases of DPS, CYFD and NMCD from the automatic cancellation of contracts and leases.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

1. Veterans will not receive resident preference for state or local procurement contracts.
2. “Pay-to-play” contracts and leases will neither be rescinded nor will procedures be adopted to prevent future contracts and leases from being “pay-to-play.”
3. Expanded details of state level and local level RFPs, contracts, and sole source and emergency procurements will not be published on the internet.

POSSIBLE QUESTIONS

Would allowing a transition of one- to two-years before cancelling contracts and leases provide for a more orderly transition to the new era where “pay-to-play” is no longer a part of our daily anxieties?