Commission on Revenue Efficiency (CORE)

March 22, 2012

The Honorable Antonio Villaraigosa, Mayor
The Honorable Wendy Greuel, City Controller
The Honorable Carmen Trutanich, City Attorney
Honorable Members of the City Council

TRANSMITTAL: PROMOTING LOCAL PROCUREMENT AND BUSINESS PREFERENCE REVIEW: DOLLARS & JOBS LOST BY THE CITY IN CONTRACTS WITH NON-LA BUSINESSES FOR GOODS & SERVICES

- *Report No. 1 of 8 Final Reports of the Commission*

Transmitted herewith is the Report submitted by the Ad Hoc Commission on Revenue Efficiency (C.O.R.E.), entitled *Promoting Local Procurement and Business Preference Review: Dollars & Jobs Lost by the City in Contracts with non-L.A. Businesses for Goods & Services.* Said Report is No. 1 of 8 Final Reports simultaneously submitted by the Ad Hoc Commission in conclusion of its term. An accompanying letter re *Final Reports & Summary of Work* includes a *Summary of Reports & Projected Revenue & Savings Impacts.*

C.O.R.E. was created by the City Council in 2010 to evaluate and recommend improvements in collections, billing and revenue and efficiency enhancements. (Council File No. 09-2560). In its first phase of work, our seven-member commission, appointed by five of the City's elected officials, issued its *Blueprint for Reform of City Collections* in the fall of 2010 -- and presented said Report to Council on May 3, 2011 (10-0225). The *Blueprint* detailed 65 specific recommendations, including C.O.R.E.'s recommendation of an Inspector General for Revenue & Collections. Further, the *Blueprint* offered a comprehensive roadmap for reform of billing and collections activities – and for the City to realize as much as $100 million or more annually in additional net revenues from departments' non-tax receivables.

The Commission has concluded its second and final phase of work with eight comprehensive reports – four focused on Business & Economic Development and another four on Collections & Efficiencies. These eight reports identify and detail the potential for additional combined revenues and savings of $100 million annually – with longer-term opportunities for up to $350 million in such additional revenues and savings annually.

The enclosed report *Promoting Local Procurement and Business Preference Review* details proposals to generate more business opportunities and sales tax revenues for the City. CORE estimates the potential for combined revenues and savings of $10-15 million annually – with significant longer-term opportunities for in excess of $100 million annually.

The Commission is grateful for the opportunity to be of service, and we look forward to your consideration of this Report.

Respectfully submitted,

Commission on Revenue Efficiency

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Commission on Revenue Efficiency (CORE)

Report Re: **PROMOTING LOCAL PROCUREMENT & BUSINESS PREFERENCE REVIEW**

DOLLARS & JOBS LOST BY THE CITY IN CONTRACTS WITH NON- L.A. BUSINESSES FOR GOODS & SERVICES

TO: The Honorable Antonio Villaraigosa, Mayor
The Honorable Wendy Greuel, City Controller
The Honorable Carmen Trutanich, City Attorney
Honorable Members of the City Council

DATE: March 2012

I. Summary

THE PROBLEM – The City of Los Angeles has long ignored its own pronouncements to buy local – spending billions of dollars each year nearly everywhere but in L.A. As a result, Los Angeles has missed the opportunity to support local businesses and to create local jobs. It has denied itself millions of dollars in tax revenues each year.

THE SOLUTIONS – In recognition of the serious problems, the City Council in October adopted an 8% local business preference to try to begin to address the problems of inequality in procurement. As Council considers next steps, this report details the inquiries and findings of the Commission on Revenue Efficiency (C.O.R.E.) about the City's procurement of goods and services from businesses outside of Los Angeles – and our specific recommended solutions. These include more outreach to local businesses, streamlining the procurement and contracting process, simplifying bid packages, revising the definition of what a "lowest responsible bidder" means and a more strategic use of cooperative purchasing alliances.

C.O.R.E. also offers its analysis of the City's just-adopted Ordinance to establish an 8% Local Business Preference Program, along with what the Commission recommends as clarifications and follow-ups – including proposals for a possible City Charter amendment to more clearly authorize City business preferences.

The Ad Hoc Commission on Revenue Efficiency (C.O.R.E.) has examined approximately $1 billion in Los Angeles City contracts for goods and services over recent six-month periods. Disturbingly, the Commission found that Los Angeles City businesses accounted for less than 8% of these contracts. Worse yet: In a nine-month period, three departments bought $60 million in vehicles – none were purchased from dealers located in the City of Los Angeles.

With its procurements, the City of Los Angeles is generating business and jobs outside the City and millions of dollars in tax revenues to jurisdictions other than itself. And, while the City rightly encourages its residents to "Shop LA," the City itself is shopping elsewhere. The City reportedly spends just 16% of more than $1 billion in General Fund procurement dollars[i] on businesses in the City, and, it appears, an even lesser percentage for purchases by its Proprietary Departments: the Los Angeles Department of Water & Power, Los Angeles World Airports and the Port of Los Angeles.

The City Council's charge to C.O.R.E. *(Council File No 09-2560)* was to evaluate and recommend improvements in billing, collections and compliance – and in the area of new revenues. Our seven-member Commission can think of few better and more important ways to generate new City revenues than to encourage, support and buy from local businesses – and to create more local jobs. And, with some plain old common sense, the City of L.A. can help our businesses, create jobs and achieve millions of dollars in new City revenues annually -- merely by resolving to focus more of the money it already spends on purchase and service contracts into local businesses. Finally, we can further help our businesses, residents and our own City Treasury by working to encourage the County of L.A. and other local public agencies, to award the many billions they already spend annually to local businesses.[ii]

Imagine all that money now going elsewhere staying in the City – to maintain vital City services.

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II. Legal Background & Issues of Concern

The scope of actions, incentives, preferences and other options that may be available to the City to achieve more local sourcing of goods and services is subject to various federal, state and local laws. Some of the more notable legal considerations are outlined below for informational purposes, and to serve as background information for C.O.R.E.'s Recommendations section. The application and interpretation of these laws is, of course, the purview of the City Attorney's Office and of legal counsel to the City.

1. **L.A. CITY CODE & CHARTER PROVISIONS RE COMPETITIVE BIDS AND PROPOSALS** – Newly Enacted Preference Ordinance: Questions & Issues

The L.A. City Charter (Vol. 1, Article III, Sec. 371) requires that most contracts be competitively bid and awarded to the lowest responsive and responsible bidder. There are, however, certain exceptions:

A. **LOS ANGELES CITY CHARTER** -- (Vol. 1, Article III, Sec. 371) references two types of competitive procurement/contracting methods: "Competitive Bidding" and "Competitive Sealed Proposals":

(a) *"**Competitive Bidding**. Contracts shall be let to the lowest responsive and responsible bidder..... Notwithstanding the provision of this subsection requiring award to the lowest responsive and responsible bidder, a **bid preference** can be allowed in the letting of contracts for California or Los Angeles County firms, and the bid specifications can provide for a domestic content and recycled content requirement. The extent and nature of the bid preference, domestic content and recycled content requirement and any standards, definitions and policies for their implementation shall be provided by ordinance."*

(b) *"**Competitive Sealed Proposals**. As an alternative to an award pursuant to open and competitive bidding, a contract can be let pursuant to a competitive sealed proposal method, in accordance with criteria established by ordinance adopted by at least a two-thirds vote of the Council."*

(e) *"**Exceptions.** The restrictions **of this section** shall not apply to: ... (8) Contracts for cooperative arrangement with other governmental agencies for the utilization of the purchasing contracts and professional, scientific, expert or technical services contracts of those agencies and any implementing agreements, even though the contracts and implementing agreements were not entered into through a competitive bid process."*

Questions and Issues -- The language of the Charter creates some uncertainty. While C.O.R.E. does not seek to opine on the laws of the City of Los Angeles, or the interpretation thereof, we note the following:

- County vs. City preference: There is a permissible bid preference for letting of contracts for "Los Angeles County Firms" – and the "extent and nature of the bid preference ... and any standards, definitions and policies for their implementation shall be provided by ordinance." Does this mean that the current City Charter could be interpreted to allow a "City" preference by Ordinance? Or, (as the Office of the City Attorney has opined to the Council) that the City may create a preference only for County firms and not specifically for City firms – unless the Charter is amended?

- Preference permitted for both "Competitive Bidding" and "Competitive Sealed Proposals"?: The local preference authorized in Subsection "(a) Competitive Bidding", is defined as a "bid preference" – and arguably applies only to bids – and not to proposals. The distinction between these two contracting methods is further underscored by the fact that Subsection "(b) Competitive Sealed Proposals" describes such proposals "as an alternative" to bidding.

  A careful reading of the authority granted in the Charter to create a "bid preference" might reasonably be interpreted to apply only to "Competitive Bidding" and not to "Competitive Sealed Proposals". Furthermore, the L.A. Administrative Code (as detailed below) states that "Section 371(a) of the City Charter authorizes *bid preferences* ..." (*emphasis added*). Accordingly, insofar as the City's just adopted Local Business Preference Ordinance would apply the preference both to "Bidding" and to "Proposals" – one is left to wonder whether the Ordinance might at a future date be deemed to be in conflict with the City Charter.

NOTE: In response to a query from C.O.R.E., the Office of the City Attorney related to C.O.R.E. that its reading of the provision related to bid preferences is not limited to 371(a). Given the fact that the matter is perhaps less than optimally clear, it may be an appropriate matter for further inquiry and/or for clarification as part of a possible Charter Amendment.

Cooperative Purchase Agreements -- Another exception to competitive bids is in Sec. 10.15, Par. 8, which exempts from competitive bidding: "Contracts for cooperative arrangement with other governmental agencies for the utilization of the purchasing contracts and professional, scientific, expert or technical services contracts of those agencies and any implementing agreements, even though the contracts and implementing agreements were not entered into through a competitive bid process."

B. **LOS ANGELES ADMINISTRATIVE CODE** – (L.A. Admin Code, Div. 10, Chapter 1, Article 9, Sec. 10.35), entitled "Bid Preference Based on Location of Firm". states:

> *"Section 371(a) of the City Charter authorizes bid preferences based on the geographical location of a bidder. Only the Council shall grant such preference and* ***no preference shall be granted other than for the award of the contracts for the automated refuse collection containers.*** *The Council, in determining the particular geographical area, be it within the State of California or County of Los Angeles, or any sub-area thereof, in which a business needs to be located, or agree to locate, in order to qualify for a bid preference, shall state the reason for such determination. The Council shall further determine the nature and extent of such preference. The adoption of this section shall be deemed authorization for any action by the City Council granting such preference. What constitutes the locating of a business within the geographical area, as to the award of a particular contract, shall also be determined by the City Council."*

Questions and Issues -- The language of the Admin. Code also would seem to create some confusion:

- This section of the Admin Code would, curiously, seem to limit the authority of the Council in the granting of preferences pursuant to Sec. 371(a) to none "**other than for the award of the contracts for the automated refuse collection containers.**" If this were to be the case, the new Ordinance may need to be supplemented or amended to strike from the Admin Code the language that seemingly limits preference(s) to "contracts for the automated refuse collection containers".

NOTE: In response to a query from C.O.R.E., the Office of the City Attorney related to C.O.R.E. that it would have been optimal to simultaneously amend the above provision of the Admin Code (or to strike the provisions related to refuse containers). Notwithstanding, the City Attorney's Office believes the new Local Business Preference Ordinance would de facto supersede Sec. 10.35. Again, given the fact that the matter is perhaps less than optimally clear, it may be an appropriate matter for further inquiry and/or for clarification as part of a follow-up "clean up" ordinance.

2. LOCAL BID PREFERENCES – AND FEDERAL & STATE LAWS

There exist limitations on how and when local bid preferences may be implemented. These limitations stem, in large part, from other laws meant to make sure government gets the best deal it can on contracts, to help avoid favoritism in government contracting and to comply with the "Commerce Clause" of the U.S. Constitution – which is interpreted to forbid most restraints on open and free commerce by, between and within jurisdictions in the U.S.[iii]

The City may also have limited rights or abilities to mandate local bid preferences for Proprietary Department expenditures that use non-City funds – such as airline or passenger fees, tidelands revenues, etc.

For those expenditures for which the City may be able to apply certain local bid preferences, the manner and extent to which the City may grant these preferences is subject to the City's own ordinances and Charter, to California statutes (including the California Public Contract Code), and to Federal codes and case law. Improperly drafted and/or overbroad local preferences are vulnerable to being struck down by the courts. (See analysis of a proposed Fresno ordinance)[iv] A Memorandum (opposing local preferences per se) of the Municipal Research and Services Center of Washington State also delineates various practical and legal issues governmental entities should consider.

3. LOCAL HIRING PREFERENCES GENERALLY

Local hiring preferences have become increasingly popular among cities and other jurisdictions. Where a City may consider a local employment preference, the policy, ordinance, or resolution establishing the preference should generally be worded to reflect a legitimate interest of the City, such as encouraging local industry, reducing local unemployment, or enhancing the local tax base. Municipal counsel generally advises that said preference(s) should target qualified unemployed resident workers -- such as workers that have signed up for unemployment assistance -- rather than targeting all residents, regardless of their qualifications or employment status. It is also generally considered advisable that local preferences establish a goal rather than a quota – especially in local hiring preferences.

4. L.A. CITY CONTRACTS AWARDED TO SMALL BUSINESSES AND BUSINESSES OWNED BY MINORITIES, WOMEN AND DISABLED VETERANS

The City of Los Angeles has established programs and policies intended to encourage and assist small businesses and businesses owned by minorities, women and disabled veterans. Most recently, on January 11th, 2011 the Mayor signed Executive Directive 14 which established the Business Inclusion Program. This program's purpose is to increase the number of City contracts awarded to such small businesses and businesses owned by minorities, women and disabled veterans. The Mayor has set department goals for small and disabled veteran business procurement as well as anticipated minority and women business participation levels. Each department is allowed to experiment and create methods to reach these goals on a quarterly basis and general managers are held accountable to ensure that the goals outlined are met. There is also an advisory committee – and quarterly Compliance Reports are being posted on the City's website. The method and process outlined in the Mayor's program would be an excellent paradigm to extend to encouraging local procurement generally.

Per the webpages of the Mayor's Los Angeles Works initiative, the Business Inclusion Program requires that all City Departments use the Los Angeles Business Assistance Virtual Network (BAVN). This network allows businesses to identify themselves as either being a certified small business, certified minority owned business, or a certified disabled veteran business. Again, C.O.R.E. recommends something similar for all local business.

III. Local Business Preference Program

1. 2011 ORDINANCE RE 8% LOCAL PREFERENCE INITIATIVE

On October 14, 2011, the L.A. City Council approved an Ordinance prepared by the Office of the City Attorney to create an "8% Local Preference Initiative". (CF: 11-1673).

The origin of this new Ordinance was in September 2010. Then, the Mayor along with Council Members Krekorian and Parks announced support for an **"8% Local Preference Initiative",** and issued a Press Release related to the initiative. In October 2010, a Motion was introduced in Council. Thereafter, on Nov. 4, 2010, the Council considered and approved establishing a local business preference ordinance to grant an 8% preference incentive to qualified local businesses that submit competitive bids or respond to an RFP. (CF 10-2414-S1).[1] The intended preference incentive was to be in addition to existing programs for small and minority-owned businesses.

The new Ordinance approved by the Council amends the L.A. Administrative Code to establish a local business preference program for procurement of goods equipment and services when the contract involves an expenditure exceeding $150,000.

Among the notable provisions:

i. The preference shall apply to all Los Angeles County businesses. (Accordingly, the preference would not be limited to City of Los Angeles businesses – based on interpretation of the L.A. City Charter's language permitting preferences for *Los Angeles County firms (See Sec. II.5 hereinabove).*

ii. Awarding authorities in the City would be required to apply an 8% bid preference in the form of additional points to the final score of proposals from qualified Local Businesses.

iii. Awarding authorities in the City would be required to apply a preference (based on a sliding scale of 1% to 5%) to a bid or proposal where – notwithstanding that contractor does not qualify as a Local Business – a local subcontractor will perform work on the contract.

iv. The maximum preference shall not exceed $1 million.

v. Shall apply only to contracts that involve expenditures entirely within the City's control – and shall not apply to contracts that involve expenditure of funds not entirely in the City's control – such as state and federal grant funds.

vi. The Ordinance shall not apply to Proprietary and certain other agencies and expenditures, including the Dept. of Water & Power, Los Angeles World Airports and the Port of L.A. "The Draft Local Business Preference Order strongly encourages the Proprietary Departments, the Dept. of Recreation & Parks, the Library Dept. and the Community Redevelopment Agency to adopt a local preference program consistent with the ordinance."

vii. A qualified Local Business must satisfy all of the following criteria:

A. The business occupies work space within the County.

B. The business must submit proof to the City demonstrating that the business is in compliance with all applicable laws.

C. The business must submit proof to the City demonstrating one of the following:

(1) The business must demonstrate that at least 50 of full-time employees of the business perform work within the boundaries of the County at least 60 percent of their total, regular hours worked on an annual basis, or;
(2) The business must demonstrate that at least half of the fulltime employees of the business work within the boundaries of the County at minimum of 60 percent of their total, regular hours worked on an annual basis; or
(3) The business must demonstrate that it is headquartered in the County. For purposes of this Article, the term "headquartered" shall mean that the business physically conducts and manages all of its operations from a location in the County.

2. C.O.R.E.'s ANALYSIS OF THE 8% LOCAL PREFERENCE – AND NECESSARY NEXT STEPS

As detailed in this report, an abysmally low percentage of L.A. City contracts for goods and services are entered into with L.A. businesses. Many local businesses are struggling – and the fact that our City looks everywhere for goods and services seems only to add insult to injury. The City must do everything it can to better support local businesses – for the sake of our businesses, for the sake of local jobs and for the sake of the City's own financial well being, which depends on a strong economy and the revenues that follow therefrom.

Supporters of an 8% local business preference see it as a great way to retain and attract local business – and to generate more revenues for the City. Critics of an 8% local business preference raise philosophical questions about interfering with the free market, and concerns about the City potentially paying more than it otherwise needs to for goods and services.

Both the supporters and the critics of local preferences generally – and of the City's new Ordinance specifically -- have salient points. Yet both may also be overstated. Moreover, calculating the costs and benefits of an 8% preference inevitably entails much guesswork. Below we summarize the favorable and potential limitations of the 8% preference – and, on balance, the benefits that may be realized. C.O.R.E. also offers our perspective on ways to minimize the downsides and to maximize the benefits of a preference. The Commission also recommends pairing the local preference with our Recommendations in Sec. IV. And, most critically, C.O.R.E. recommends clarifying and resolving the legal issues and impediments to a comprehensive "City" preference – if, need be, by Charter amendment placed before the voters of Los Angeles.

A. 8% Local Preference – the Favorable:

i. **<u>The scope of the new Ordinance is limited</u>** – The City Attorney's Office added into its draft of the now-approved Ordinance (*see Sec. III.1, above*) several limiting provisions that supplement the Council's original Motion. In the opinion of C.O.R.E., these limitations –

including an overall dollar limit on the preference – are, taken together, thoughtful and appropriate.

ii. **<u>We need to "level the playing field"</u>** -- We are already operating in something less than a free market. As detailed in Appendix "C", and in the City Attorney's report to the Council, many other local governments have local preference ordinances that serve to support their local businesses – placing L.A. businesses at a disadvantage in many of those other jurisdictions. This fact, coupled with the acknowledged higher costs of doing business in L.A., suggest that local preferences can serve to simply "level the playing field" for our local businesses.

iii. **<u>We need to try something new</u>** -- The City has in place certain incentives to assist and encourage contracting with, and purchasing from small businesses and businesses owned by minorities, women and disabled veterans. While these are very important programs, they have, unfortunately, not succeeded in helping our City focus a substantial percentage of its contracting locally. We need to do more.

B. 8% Local Preference – the Limitations:

C.O.R.E. would be remiss if we did not also point to some of the potential limitations to an 8% local preference (separate and apart from the issues and concerns detailed in our discussion of the Charter and Admin Code, *above*):

i. **<u>The scope of the Ordinance is limited</u>** – Just as this fact serves as "pro" argument for the local preference; it can also serve as a limitation in that it will not apply to Proprietary departments of the City or expenditures that involve certain grants. With the City spending more on outside goods and services through its Proprietaries than through the General Fund, the ultimate benefit of the Ordinance will be limited. That said, the Proprietaries can and should be encouraged to follow suit.

ii. **<u>The Ordinance would help L.A. County competitors to L.A. City businesses</u>** -- The new Ordinance creates a local incentive for Los Angeles County businesses, not specifically Los Angeles City businesses. This means that a Burbank company would benefit equally from the initiative as a City of Los Angeles business. Take as an example the recent $60 million in vehicle purchases by the City's Proprietary departments (See into to this Report, and Sec. V.7, and Endnote viii below). While shockingly none of the purchased were from L.A. City dealers, more than half of the purchases were from L.A. County dealers in Alhambra and West Covina. Imagine if we had provided them with an 8% bid preference on the multiple bids they won. It would have potentially needlessly cost the City millions of dollars.

iii. **<u>Is an 8% local preference really revenue-neutral? / Problems with underlying Report(s)</u>** -- Among the justifications underlying the Council's November 2010 Motion for an 8% preference, and the resultant Ordinance, was a July 2010 report by Professor Charles Swenson from U.S.C.'s Marshall School of Business, entitled: <u>"The Potential Impact to Los Angeles of Local Vendor Preferences for City Contracts"</u>. The U.S.C. Report predicted the City would likely recoup the added costs associated with an 8% bid preference, and likely make money in the form of other new revenues. Unfortunately, at the time the Motion was adopted – and through today – there has been no independent analysis of the numbers in the U.S.C. Report. Neither the CAO nor the CLA had completed a financial analysis.

Furthermore, C.O.R.E.'s analysis (Specifically detailed in Appendix "A", below), suggests that the projections are questionable. As detailed in Appendix "A", C.O.R.E. has serious questions about the assumptions and projections in the U.S.C. Report – including questions about (a) assuming a 2X multiplier for each dollar spent by the City within the City, (b) the report's gross receipts tax assumptions, (c) accounting for the economic impact of businesses that may not be located in L.A. but doing businesses here nonetheless, and (d) avoiding "bid inflation". Adding to C.O.R.E.'s concerns is the fact that that the U.S.C. Report has been repeatedly revised each time problems about it have been brought to the fore. (Again, see Appendix "A").

Accordingly, after much discussion, the Commission cannot say with confidence that an 8% local bid preference would be revenue-neutral. Accordingly, it will be for the decision-makers in the City to determine other balancing benefits to an 8% local preference.

iv. **No <u>empirical evidence of effectiveness of the a local preference</u>** – Even the above-referenced U.S.C. Report states: *"For cities which have local bidding preferences, there is no empirical evidence as to 1: how often a local bidder wins; 2. When the local firm wins, if the price is inflated beyond the price offered by a non-local vendor; and 3. When the non-local bidder wins, how much the City gains in terms of more competitive pricing resulting from the bidder preference option." (See* Appendix "A", Sec. 1.C.).

C. On balance:

The consensus among the Commissioners of C.O.R.E. is that local bid preferences can, in fact, be helpful. Is 8% the right number – and will it be revenue neutral? These are questions that are difficult to answer with certainty given the numbers we have seen. As the Commission has also noted in the "pro" and "con" sections above, the likely limited scope of the application of the preferences will be both an advantage in limiting potential downsides for the City, and a disadvantage in limiting potential upsides. That said, every governmental initiative inevitably involves some pros and some cons. And there are inevitably ancillary benefits to supporting our local businesses.

D. Moving Forward – and Necessary Next Steps:

When the Council voted to approve the new Local Preference Ordinance, there was general acknowledgement by the Council and by the Office of the Mayor that it was not a perfect Ordinance – perhaps there's no such thing. And while there was consensus that a "County" preference was less desirable than a "City" preference, the Council approved the Ordinance drafted by the Office of the City Attorney – with a request by the Council for recommendations to address this shortcoming – along with others.

Accordingly *(as detailed in Sec. IV. of this report, below)*, C.O.R.E.'s offers its Recommendations for immediate clarifications of questions related to the new Ordinance, for moving forward and for what we believe are necessary next steps.

IV. Recommendations

The Commission offers below its recommendations for actions we believe can be immediately achieved and impactful in boosting local business, jobs and revenues for the City. In brief, the Commission believes a little bit of common sense by procurement officers and decision makers in the City could go a long way.

C.O.R.E. recommends:

LOCAL VENDOR PREFERENCES AND LOCAL BUSINESS PREFERENCE PROGRAM FOLLOW-UPS

1. **C.O.R.E. recommends the following clarifications and follow-ups to the City's just-adopted 8% Local Business Preference:**

    a. **Clarifying accord of the Ordinance with the Charter and Admin. Code.**

        i. **Application of New Ordinance to Competitive Sealed Proposals**: Is application of a preference to "Competitive Sealed Proposals" possibly in conflict with the Charter? As detailed in the paragraphs, above, entitled: "Questions and Issues" (Sec. II.1.A & B), the authority granted under the Charter for a local preference could be read to relate only to Sec. 371(a) of the Charter: "Competitive Bidding" – and not to Sec. 371(b) - "Competitive Sealed Proposals". C.O.R.E. recommends requesting the Office of the City Attorney to memorialize its construction of the Charter extending the bid preference of Sec. 371(a) to Sec. 371(b).

        ii. **Potentially Limiting Language in the Admin. Code:** Again, as detailed in the paragraphs, above, entitled: "Questions and Issues" (Sec. II.1.A & B), C.O.R.E. recommends clarifying whether the language of the Admin. Code (<u>L.A. Admin Code, Div. 10, Chapter 1, Article 9, Sec. 10.35</u>) may need to be amended to avoid conflicting with the new Ordinance. Referencing Charter Sec. 371(a), the Admin Code perplexingly states *"no preference shall be granted other than for the award of the contracts for the automated refuse collection containers."* Even if provisions of Sec. 10.35 that are in conflict with the new Ordinance are deemed to be superseded by the new Ordinance, leaving the conflicted language of 10.35 in place is less than optimal.

    b. **Seeking further guidance as to whether the Charter could reasonably be interpreted to allow a "City" preference to be adopted by Ordinance**. While the City Attorney has opined that such a City preference would require a Charter amendment, and while C.O.R.E. has the highest regard and respect for the judiciousness of said office, C.O.R.E. recommends further inquiry into this interpretation of the current Charter.

    c. **Possible Charter Amendment** – If, in fact, the current City Charter is interpreted to mean only L.A. "County" and not L.A. "City" preferences are permissible, C.O.R.E. recommends that a Charter amendment be drafted and presented to the voters as early as practicable. Recommended components:

i. Language specifically authorizing L.A. "City" preferences.

ii. Language to make clear the Council's authority to adopt preferences under Sec. 371(a), (b) and other sections, as may be appropriate.

iii. Revisions of various other definitions and requirements in Charter Sec. 371.

iv. Language that might in some way either authorize a preference that could be imposed upon the City's proprietary departments – or, if that would not be legally permissible, perhaps some language re minimal steps the departments must take to reach out to local bidders. (It may be possible to accomplish the latter through an Ordinance instead of through an amendment to the Charter).

GATHERING THE FACTS:

2. **That the Council request that the Department of General Services (GSD), with the Chief Administrative Officer (CAO) and the Chief Legislative Analyst (CLA), prepare and present a report to detail:**

    a. Annual expenditures for taxable goods by the City and each of its Departments, including information about where these goods are being purchased, general categories of such goods, and a breakdown of sales and use taxes paid on those purchases. C.O.R.E. believes that there is significant potential to boost the amounts of sales tax back the City receives for its purchases. By way of illustration, the City may place an order for office supplies from Staples in L.A. or through, for example, La Mirada. This can make a difference in which jurisdiction gets the sales tax.

    b. The type and amount of purchases made through cooperative purchase agreements with other government entities.

    c. Possible recommendations to update purchasing guidelines to achieve a higher percentage of City contracts entered into, and with, L.A. City businesses. (Note: C.O.R.E. recommends target and/or goals as distinguished from quotas).

3. **That the Council instruct the Office of Finance to report on Business Taxes paid by all L.A. City vendors. Said report to include a breakdown of said tax paid by vendors located both in and out of the City of Los Angeles.** Roughly 66,000 businesses based outside of Los Angeles paid a total of $38 million in gross receipts taxes in 2010 – for all business conducted within the City of L.A. These businesses, however, only represented less than 15% of the total businesses paying such taxes, and they paid less than 10% of the total business tax revenues realized by the City of Los Angeles in that year. These numbers lead the Commission to wonder whether the City is adequately tracking and billing those businesses outside of L.A. who are doing business in the City – including those who are City vendors. These businesses should, if they are not already, be required to obtain and maintain a business license, and to pay all applicable business tax for all business conducted by said businesses within the City, prior to – and during the term of -- any business conducted with the City.

4. **That the Council requests a presentation from the Mayor's ShopLA Team.** This team has been working to encourage more local purchasing, and the information and methods gathered by the Team have valuable application to City purchasing.

IDENTIFYING, RECRUITING & ENCOURAGING LOCAL BIDDERS

5. **Council instruct the Department of General Services (GSD) and all City Departments that purchase goods and services to implement a policy to identify and recruit local bidders.** GSD and City Departments would be required to independently ascertain whether or not there are appropriate local bidders for contracts exceeding a given threshold (say $50,000). If such local bidders exist, there should be an assertive policy of reaching out to them. The stage at which such identification of, and outreach to, local bidders would occur should be early on in the procurement and contracting process.

6. **Council instruct the Department of General Services (GSD) and the contract and procurement divisions of the City's Proprietary Departments to report on their efforts and initiatives to improve outreach** to local businesses – and to encourage and assist in their submission of bids for City contracts. Further, GSD should report on any coordinated outreach efforts with the Mayor's Business Team, and also report on what type of coordination may exist with departments that do substantial amounts of purchasing and contracting independently of GSD.

7. **Council instruct the Department of General Services (GSD) and the contract and procurement divisions of the City's Proprietary Departments to report on recommendations for simplification and streamlining of bid packages.** The longer and more complicated the bid packages have become, the more difficult it has become for businesses to bid.

8. **Council instruct the Department of General Services (GSD), in coordination with the Office of the Mayor, to compile, maintain, update and distribute quarterly reports on the dollar amounts and percentages of contracts awarded to local business** by General Fund Departments, Proprietary Departments and Enterprise Departments (such as the Bureau of Sanitation) – and on the effectiveness of the Local Preference Initiative.*

   * ***NOTE: C.O.R.E. recommends a paradigm similar to that created*** *pursuant to the Mayor's January 11, 2011 Executive Directive 14, establishing the Business Inclusion Program. (See Sec. II.8, above). Included in said paradigm are an advisory committee and quarterly Compliance Reports posted on the City's website. The Los Angeles Business Assistance Virtual Network (BAVN) also allows businesses to identify themselves as being certified in advance.*

9. **Consolidate all information about bidding and local business preferences and programs in one place.** Currently, there is information on BAVN, on an outdated webpage of the Mayor's Business Team, on the webpages of the Mayor's Los Angeles Works initiative, and other locations. C.O.R.E. recommends "one-stop-shopping".

COOPERATIVE PURCHASING ALLIANCES[v]

10. **That the Council instruct the Department of General Services (GSD) to report on the percentage of purchases currently made through cooperative purchasing alliances.** The City of L.A. is a party to several cooperative and multi-jurisdictional purchasing agreements, whereby the City buys certain goods at prices negotiated by the cooperative. The government purchasing alliance, U.S. Communities, is one such example.

We must note the irony that while all other bids must follow competitive bidding procedures in the City, the use of purchasing alliances essentially bypasses the complexities of the City's own system – potentially creating a two-tier system.

One way to increase business generated for local vendors is to make sure that L.A. companies are actively engaged in providing goods and services through such cooperatives. The City might also consider creating its own cooperative.

NOTE: the City of L.A. is a registered agency with U.S. Communities Government Purchasing Alliance -- more than 44,000 registered public agencies utilize U.S. Communities government cooperative contracts to procure more than 1 billion dollars in products and services annually.

11. **That the Council and Mayor work with officials of Los Angeles County, the Los Angeles County Metropolitan Transportation Authority (Metro), the Los Angeles Unified School District (LAUSD) and other major local agencies to encourage their implementation of comprehensive local procurement strategies.** The County of Los Angeles alone issued more than $5 billion in purchase orders and contracts for goods and services in FY 2010-2011. In July of 2011, the County's Board of Supervisors approved an 8% local preference for County goods and services contracts. (11-3343). This update to the County Code will only apply to select small businesses, which make up a small portion of overall County contracts. If the City can get the County and others to buy more locally, the City will be a substantial and direct beneficiary in jobs and in local business and sales tax revenues.

TAKING SALES TAX IMPACTS INTO CONSIDERATION

12. **That the Council request that the City Attorney prepare the draft of an ordinance amending the definition of "lowest responsible bidder" in the City's Code(s).** C.O.R.E. recommends including a provision whereby the term takes into consideration the sales tax the City would receive back ("tax back") for purchases it makes from businesses in the City vs. businesses outside the City (approximately 1%). (See Appendix "A"). *(See also Endnote ix for additional information, resources and caveats re the 1%).*

Taken together, C.O.R.E. believes we can correct the current contracting imbalance – to the benefit of the City, its businesses and its residents.

V. Background: Scope of L.A.'s Contracting With Non-L.A. Businesses

While contracting with non-Los Angeles-based businesses does not necessarily mean that all the money and businesses associated with a particular contract accrue outside the City *(see Endnote vii)*, a significant number of such non-local contracts means overall less business and money staying locally.

Both the City itself, and the June 2010 U.S.C. Report, have previously reported that the City was spending in excess of $1 billion annually on contracts with outside vendors -- of which only $180 million (16%) was spent on City-based firms. Billions more are being spent by the City's Proprietary Departments: L.A. Dept. of Water & Power, L.A. World Airports and the Port of L.A. The June 2010 U.S.C. Report also found that 32% of state and local governments surveyed had some sort of local procurement preference – while L.A. did not.

More recently, as noted above, C.O.R.E. has examined approximately $1 billion in L.A. City contracts for goods and services over recent six-month periods. L.A. City businesses accounted for less than 8% of these contracts.

Specifically, C.O.R.E. found:

1. CONTRACTS BY PROPRIETARY DEPTS. WITH NON-L.A. COMPANIES *FOR GOODS*

A mere 2% of nearly $322 million in goods procured by three proprietary City departments over recent six-month periods were purchased from City of Los Angeles businesses. C.O.R.E. examined a total of 67 contracts[vi] awarded by these departments: 49 by L.A. Dept. of Water & Power (from July 1 – Dec. 31, 2010), 11 by Los Angeles World Airports and 7 by the Port of L.A. (both from Jan. 1 – June 30, 2011). 41% of the contracts were awarded to companies located in other states. In each case, the purchases were subject to sales tax *payable* by the City – to other jurisdictions.

- 28 bids valued at $132,047,450.00 were awarded to companies located in other states (40% of the winning bids, 41% of the dollar value).
- Four valued at $18,819,983.00 were awarded to companies located in other countries (6% of the winning bids, 6% of the dollar value).
- 33 valued at $164,529,434.00 were awarded to companies located in California jurisdictions outside of the City of Los Angeles (47% of the winning bids, 51% of the dollar value).
- Five bids valued at just $6,578,585.00 were awarded to companies located within the City. (7% of the winning bids, 2% of the dollar value).

2. CONTRACTS BY PROPRIETARY DEPTS. WITH NON-LOS ANGELES COMPANIES *FOR PERSONAL SERVICES AND CONSTRUCTION*

A mere 11.5% of more than $632 million in professional service and construction contracts examined by C.O.R.E. were awarded to City of Los Angeles businesses. Of the 71 contracts studied by the Commission by L.A. Dept. of Water &

Power, L.A. World Airports and the Port of L.A., 67.3% of the dollars were spent with companies located in other states -- a total of 71 such contracts valued at $632,129,195 were awarded.[vii]

- 17 contracts valued at $425,258,621 were awarded to companies located in other states (24% of the contracts, 67.3% of the dollar value).
- Nine contracts valued at $4,113,701 were awarded to companies located in other countries (12.7% of the contracts, .06% of the dollar value).
- 33 valued at $120,615,930 were awarded to companies located in California jurisdictions outside the City (46.5% of the contracts, 19% of the dollar value).
- One contract valued at $9,500,000 was awarded to the US Army Corps of Engineers (1.4% of the contracts, 1.5% of the dollar value).
- Eleven contracts valued at $72,640,943 were awarded to companies located in the City of Los Angeles (15.5% of the contracts, 11.5% of the dollar value).

(Note: Certain contracts by their nature require contracting abroad – such as Port contracts with foreign trading agents.)

3. FLEET PURCHASES BY THE CITY

Worse yet, zero percent of more than $60 million in vehicles purchased by proprietary departments since July 2010 were purchased from City of Los Angeles dealers.[viii] A total of eight bids were awarded by LADWP and the Port of LA for various vehicles. Roughly $6 million in sales tax was paid by the City of L.A. for these purchases – largely to the benefit of the state and seven other local jurisdictions. At least $600,000 of the tax (about 1% of the purchases) would have come back to the City (for the benefit of its general fund) had the purchases been made within the City. Instead, other cities such as Costa Mesa, Fontana and Sacramento now have more money to repave their streets and maintain their police and fire departments. *(See Endnote viii and ix for additional information, resources and caveats re the 1%).*

4. PURCHASE ORDERS PLACED THROUGH GSD FOR NON-PROPRIETARY DEPARTMENTS:

Purchase orders using vendors within City & County
January 1, 2011 to June 30, 2011
Source: City of L.A. GSD

	# of PO's	$ Amount
LA City only	11,322	$22,229,626.87
LA County (outside of City)	18,115	$67,580,870.69
Total LA County	29,437	$89,810,497.56
Total Purchases made (irrespective of Vendor Location):	45,416	**$190,607,636.17**

VI. Revenue Impacts

- **The City of L.A. expends billions of dollars annually through its contracts for myriad goods and services. With better procurement practices, the City will realize enhanced sales tax revenues, lower sales tax expenses – along with the multiplier effect of more businesses, jobs and various other tax and permit revenues. For every $100 million in taxable purchases the City itself makes, we have the opportunity to achieve more than $1 million in sales tax revenues back to the City. Moreover, if the City merely increased its sales tax revenues per capita to the average for all other cities in L.A. County, the City could generate another $61 million in additional annual general fund revenues – just from sales tax. And, getting other local agencies to buy local would have a significant impact in and of itself. Applying an exact dollar estimate to all of the benefits of local purchasing is an inexact science. Notwithstanding, with more emphasis on local procurement by the City, CORE estimates the potential for combined revenues and savings of at least $10 - $15 million annually – with significant opportunities for in excess of $100 million annually.**

1. SALES TAX

Sales tax is both a substantial revenue source and a substantial expense for the City of Los Angeles.

A. L.A.'s Sales Tax Revenues:

- Sales tax revenue constitutes the 5th largest source of General Fund revenue for the City of L.A. – totaling roughly $300 million annually.
- Currently, however, L.A. is a net exporter of sales tax revenues to outlying municipalities. In fact, L.A. ranks 16th out of 17 contiguous cities in per capita sales tax revenue generation – and 8th among California's 10 largest cities. (Per CA State Board of Equalization annual reports).
- While the City of L.A.'s population makes up approximately 40% of L.A. County's nearly 10 million residents, taxable sales in the City of L.A. make up just under 30% of taxable sales in L.A. County ($39.3 billion in the City vs. $131.9 billion Countywide in 2008).
- The City of L.A.'s lagging taxable sales results in significantly reduced sales tax revenues per capita for the City – which has been realizing annual sales tax revenues per capita, 21% lower than the average for other cities in L.A. County, and 35% lower for other cities in California.
- If the City merely increased its sales tax revenues per capita to the average for all other cities in L.A. County, the City could realize another $61 million in additional annual general fund revenues.
- Increasing L.A.'s sales tax revenues per capita to just ½ of the County cities average would yield more than $30 million per year for the City of L.A. Thus, a concerted effort to increase consumer and business purchases will yield vital dollars for the City's General Fund, as would a concerted effort by City government to buy goods and services from City businesses.

B. L.A.'s Sales (and Use) Tax Expenses:

The City of Los Angeles pays sales tax on nearly every good it purchases in California (As of July 1, 2011, the rate in most parts of the County is 8.75%). For purchases outside of California, an equivalent use tax is due and payable. This translates into well over $100 million in sales (or use) tax paid by the City each year for its purchases. Generally, for purchases made in the City of L.A., 1% of the purchase price (or about 11% of the sales tax paid) is distributed to L.A. for the benefit of its General Fund. The City also benefits from another 1.5% of the purchase price (or about 29% of the sales tax paid) that goes to the County for transportation (including Measure R money). *See Appendix "A" for a breakdown.*

Purchases made by the City from businesses in other California jurisdictions typically mean the other jurisdictions – and not L.A. – benefit. Purchases made out of state are subject to "use tax" (equivalent to the sales tax) that must typically be paid by the purchaser. While a portion of the use tax paid by the City comes back to us, it is not as beneficial to the City as if the purchase had been made from a business located here. It must be noted that the rules for distribution, allocation, sharing and countywide pooling of sales tax revenues are very complex. Moreover, the distribution of the City's and/or County's share of sales tax can depend on many factors, including where the good is purchased, where it is delivered, the location of the seller, the location of the buyer, whether the seller has multiple business locations, and what type of good is being sold. *(See Endnote ix for additional information and resources).*[ix]

Interestingly, the purchasing power of Proprietary Departments might be viewed as a way to generate sales tax revenue for the City's General Fund. The Proprietaries use non-General Fund money to buy taxable goods; any sales tax generated by purchases from businesses located in the City accrues to the benefit of the General Fund. Unfortunately, the departments rarely purchase taxable goods from businesses located in the City, which means that the City's General Fund does not receive the local share of sales taxes on the vast majority of purchases made by the departments. Instead, again, the local share in most instances goes to other jurisdictions.

2. LOST BUSINESSES & JOBS

Different reports may have different numbers – but one thing is clear: Local purchasing boosts businesses and jobs. The failure to do so costs businesses and jobs.

3. LOST BUSINESS TAX REVENUES

When the City of L.A. contracts with non-city businesses for goods and services, those non-city businesses are required to pay local business tax on the gross receipts they realize from doing business in the city. However, enforcement and collection of the gross receipts tax is often less effective with non-L.A.-based businesses. (The Commission recommends that evidence of a City Business Tax Certificate be provided either at the time of bid or before contract execution.) Moreover, by failing to buy in L.A., we lose all or part of the local "multiplier effect" – and the concomitant business taxes that would have resulted therefrom.

4. OTHER LOST REVENUES

When the City contracts for goods and services within the City, local businesses prosper in a multitude of ways. Among other things: they make improvements and expand their business locations – which results in increased L.A. Dept. of Building & Safety permitting fees; expanding businesses mean more property tax revenues for the City of L.A.; and as local businesses buy more equipment, machinery and supplies, they pay more Personal Property Tax Assessments to the County -- a portion of which is shared with the City.

Respectfully submitted,

Ad Hoc Commission on Revenue Efficiency

Ron Galperin, Chair
Hon. Cindy Miscikowski, Vice Chair
Mark Ames, Commissioner
David Farrar, Commissioner
Michael Gagan, Commissioner
Cheryl Parisi, Commissioner
Brandon Shamim, Commissioner

CC: Budget & Finance Committee
Jobs & Business Development Committee
Information Technology and General Services Committee
Miguel A. Santana, City Administrative Officer
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+ ***The Commission would like to specially acknowledge and thank Commissioner Michael Gagan for contributing his outstanding research to this report, along with Patrick Lantz, an Associate at Kindel Gagan.***

ENDNOTES

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i The City of L.A. purchases in excess of $400 million annually through its Supply Management System. This number does not reflect purchases made outside of the SMS system, including those made by Proprietary Departments such the L.A. Dept. of Water & Power, World Airports and the Port of L.A., nor does it include capital improvements.

ii C.O.R.E.'s Chair simultaneously serves on the County of L.A. Quality & Productivity Commission. In said capacity, he is currently working on a motion that would be introduced by members of the Board of Supervisors to request report-backs to the BOS re the County's purchases, percentages of local purchases, and distributions of sales and use tax paid by the County and its Departments.

iii Per the U.S. Constitution, Article I, Section 8, Clause 3: "[The Congress shall have Power] To regulate Commerce with foreign Nations, and among the several States, and with the Indian tribes ..." This clause was intended, and is interpreted to preclude states (and other government entities and jurisdictions in the U.S.) from discriminating against one another. Thereafter, in response to rapid industrial development and an increasingly interdependent national economy, Congress enacted the Interstate Commerce Act in 1887 and the Sherman Antitrust Act in 1890.

iv Note: The analysis of the proposed Fresno ordinance by the Assoc. of General Contractors is the association's analysis – and not necessarily accepted universally or in whole.

v ***Multi-Jurisdictional Purchasing Alliances & Associations***:

- U.S. Communities Government Purchasing Alliance: www.uscommunities.org
- National Council of Public Procurement & Contracting: www.goncppc.org
- Western States Contracting Alliance: www.aboutwsca.org
- California Association of Public Procurement Officials, Inc. (formerly California Association of Purchasing Officers, Inc.): www.cappo.org
- National Association of State Procurement Officials: www.naspo.org
- Los Angeles Metro Public Purchasing Agents' Cooperative: www.lamppac.org

vi The $321,975,452.00 in contracts were based on competitive low-bid awards. Not included were purchases made under previously-approved purchase orders or purchases made under the respective General Managers' authority.

vii While there may be sales tax components embedded in these contracts, no effort was made to determine what those components might be. It is also acknowledged that much of the work under these contracts will be undertaken within the City.

viii Below are 6 months of fleet purchases by the City on which the City paid sales taxes. The local share of the sales tax went in the amounts listed to the non-L.A. jurisdictions:

LADWP	Product	Cost	Dealer Location
5/11	234 pickups	$ 6,732,789.00	Alhambra
	678 pickups	21,359,896.00	West Covina
	102 rough terrain vehicles	3,877,849.00	Alhambra
8/10	2-axle stake bed trucks	5,762,954.00	Fontana
	2-axle dump trucks	1,398,482.00	Alhambra
	2-axle dump trucks	16,022,084.00	Fontana
9/10	160 ¾-ton pickups	4,848,970.00	Sacramento

PORT OF L.A.

3/11	11 Ford Escape Hybrids	$368,902.00	Costa Mesa

	Sales Amount	Local Sales Tax Share
Fontana	$21,785,038.00	$217,850.00
West Covina	21,359,896.00	213,359.00
Alhambra	12,009,120.00	120,091.00
Sacramento	4,848,970.00	48,490.00
Costa Mesa	368,902.00	3,689.00
Total:	$60,371,926.00	$603,719.00

ix

Sales Tax Rates and Allocations:

Under the Bradley-Burns Uniform Local Sales and Use Tax Law, most retail sales are deemed to occur at the retailer's place of business in this state where the sale is negotiated. (Exceptions may include certain auctioneers, vending machine operators, and construction contractors). If the retailer has more than one place of business in this state, the sale is deemed to occur at the location where the principal negotiations take place. Generally, the combined 1 percent state and local sales tax portion of the statewide 7.25 percent sales and use tax is allocated to the jurisdiction where the retailer's place of business is located, and the local use tax is generally allocated through the countywide pool where the property is used.

District taxes are additional transactions (sales) and use taxes imposed within special tax districts. For purposes of distributing the district tax, the tax generally follows the merchandise. That is, the tax is distributed to the district where the goods are delivered (and presumably used). District tax distributions are, therefore, affected by the definition of place of sale, which relies on several factors that also determine if district tax is applicable.

CA Board of Equalization Regulation 1823.4, Place of Delivery of Tangible Personal Property-Generally, *provides an exemption for the purposes of the use tax, not the transactions (sales) tax. A retailer may be relieved of the obligation to collect the use tax (for sales other than vehicles, aircraft, and vessels) imposed by a district when you ship or deliver merchandise (tangible personal property) outside of that district to a purchaser's principal residence address or principal business address.*

Under a Board of Equalization resolution adopted in 1994, an installing construction contractor or subcontractor may elect to obtain a sub-permit for the job site of a contract valued at $5,000,000 or more. As such, construction sites can be deemed a point of sale, and local jurisdictions have the opportunity to receive the local tax on materials consumed and fixtures furnished by the contractor directly, rather than through the countywide pooling process.

Motor Vehicles:

The tax rate applicable to certain "commercial vehicles" depends on the location where they are used. For the purposes of Regulation 1823.5, "commercial vehicle" means a vehicle required to be registered under the Vehicle Code, used or maintained for the transportation of persons for hire, compensation, or profit or designed, used, or maintained primarily for the transportation of property. Passenger vehicles which are not used for the transportation of persons for hire, compensation, or profit are not commercial vehicles.

The place of use determines the tax rate regardless of the location of the property when it is first purchased. See publication 44, Tax Tips for District Taxes, *and BOE Publication No. 34, Motor Vehicle Dealers. Note: "motor vehicle" means a passenger vehicle (designed to carry no more than ten people, including the driver) such as an automobile, minivan, or sport-utility vehicle. The term also includes light-duty pickup trucks (payload capacity under one ton). Different rules apply to other vehicles.*

APPENDIX "A"

C.O.R.E.'s REVIEW AND ANALYSIS OF U.S.C. REPORT(S) ON LOCAL VENDOR PREFERENCES FOR CITY CONTRACTS

Among the justifications underlying the Council's November 2010 Motion for an 8% preference – and the resulting Ordinance approved October 14, 2011 -- was a July 2010 report by Professor Charles Swenson from U.S.C.'s Marshall School of Business, entitled: "The Potential Impact to Los Angeles of Local Vendor Preferences for City Contracts". The July 2010 U.S.C. Report stated that a very broad 8% local preference would likely be of no net cost to the City.

As detailed below, C.O.R.E. has serious questions about the assumptions and projections in the 2010 U.S.C. Report, along with the three subsequent revisions thereto. These include questions about (a) assuming a 2X multiplier for each dollar spent by the City within the City, (b) the report's gross receipts tax assumptions, (c) accounting for the economic impact of businesses that may not be located in L.A. but doing businesses here nonetheless, and (d) avoiding "bid inflation".

1. FOUR VERSIONS OF THE U.S.C. REPORT

A. June 2010 Report -- (Ver. 1.0)

Among the justifications underlying the new L.A. Ordinance was a July 2010 report by Professor Charles Swenson from U.S.C.'s Marshall School of Business, entitled: "The Potential Impact to Los Angeles of Local Vendor Preferences for City Contracts" (the "U.S.C. Report Ver. 1.0"). Most notably, the **U.S.C. Report Ver. 1.0 estimated** that for each $1 million in locally awarded bids, the City would "be better off by approximately 10 jobs" and "**at a preference rate of 8%, the City *should* make money on local preference.**" [iv]

B. September 7, 2011 Report – (Ver. 2.0)

Based on C.O.R.E.'s questions and concerns posed to the author of the U.S.C. Report, the author issued a revised report Sept. 7, 2011 (the "U.S.C. Report Ver. 2.0). The new report states that: "This paper should be viewed as a replacement to the July 2010 paper."

While the U.S.C. Report Ver. 1.0 stated that "at a preference rate of 8%, the City should make money on local preference", **the U.S.C. Report Ver. 2.0** is more qualified in its predictions and uses a preference rate of 5% as the basis for its conclusion that "such preferences can potentially increase City of Los Angeles jobs at no cost to the City." The report estimates that adding together the sales and other tax gains from contracting locally ***could bring*** **"the estimated total revenue effect to roughly 5%."**

This second Report further qualified its predictions:

> *"A local bidding preference of 5% for City of Los Angeles contracts would appear to be beneficial to the City in terms of increased local employment at potentially no net cost to the City. However, this conclusion should be moderated by two factors. First, there is a recommendation that the City's business tax be repealed over time. Should this occur, any potential increased revenues from local bidders winning a contract, calculated above, would be reduced. Second, the City should consider methods to ensure that firms which represent themselves as Los Angeles companies do in fact have a real presence in the City. This would help obviate situations where non locally-based firms set up "shell" companies in the City in order to receive preference points. Finally, while increased awarding of contracts to Los Angeles based firms would certainly increase City revenues, it should be noted that even non-locally based firms which win contracts still pay City taxes, although these taxes would certainly be much higher if these companies were in Los Angeles."*

C. September 18, 2011 Report – (Ver. 2.1)

On September 18, 2011, the author of the U.S.C. Report issued a subsequent revision of the report: (U.S.C. Report Ver. 2.1). Said version seeks to offer calculations where a 5% local vendor bidding preference ***might be beneficial*** to the City. The new report also includes **a significant caveat:**

> *"For cities which have local bidding preferences,* ***there is no empirical evidence*** *as to 1: how often a local bidder wins; 2. When the local firm wins, if the price is inflated beyond the price offered by a non-local vendor; and 3. When the non-local bidder wins, how much the City gains in terms of more competitive pricing resulting from the bidder preference option."*

This third Report repeated the same qualification of its predictions as the second version (see above) – except, now the author again was predicting based on 8% vs. 5%.

D. September 20, 2011 Report – (Ver. 2.1b)

On September 20, 2011, the author of the U.S.C. Report issued a subsequent revision of the report: (U.S.C. Report Ver. 2.1b). Said revision was, according to the author, reflecting comments received by the author from Mayor's Office. Said fourth version did not contain significant changes from the third version – nor, however, did it address many of the same concerns about the accuracy of the numbers and predictions outlined by C.O.R.E., and detailed hereinbelow:

2. QUESTIONS AND CONCERNS RE THE U.S.C. REPORT(S)

C.O.R.E.'s specific (and ongoing) questions and concerns regarding the U.S.C. Report(s) are as follows:

A. *Direct cost(s) to City* –

i. Initial Report -- The initial U.S.C. Report's calculations and projections are based on a supposed example where a non-local bidder bids $990,000 while the local bidder bids $1 million. In this example, awarding the contract locally with an up to 8% local preference has a direct cost differential to the City of only 1%, or $10,000.

- *Problem: The Report uses an example where the direct cost to the City is just 1%. With an 8% local bid preference, however, there could be up to an 8% or $80,000 direct cost differential for the City. While an 8% local preference will not always mean an 8% price differential, what's the basis for only a 1% differential, and how would the projections be impacted if the actual differential exceeds 1%?*

ii. Subsequent Reports -- In the 3 subsequent versions of the Report, the author offers calculations and projections as follows:

a. The author offers a supposed example of a contract where the local bidder cannot bid below $100,000 and still make a profit. Without a preference, a non-local competitor would (the author predicts) win with a bid of $99,000. With a 5% preference rule, the author of the U.S.C. report reasons, the competing national firm would be forced to bid below $95,000 to win the bid. The author then assumes the non-local bidder would bid $94,000 – and the City would be better off by $5,000 even if the non-local bidder wins ($99,000 - $94,000).

- *Problem:* ***It is the opinion of C.O.R.E. that these numbers are nothing but sheer and utter conjecture.***

b. The author offers a second supposed example where a non-local bidder bids $990,000 while the local bidder bids $1 million. In this example, awarding the contract locally with up to a 5% local preference again has a direct cost differential to the City of only 1%.

- *Problem: As with the initial version of the Report, this is an example where the direct cost to the City is just 1%. With a 5% local bid preference, however, there could be up to a 5% or $50,000 direct cost differential for the City. While a 5% local preference will not always mean a 5% price differential, what's the basis for only a 1% differential, and how would the projections be impacted if the actual differential exceeds 1%?*

B. Multiplier effect –

i. Initial Report -- The initial U.S.C. Report's calculations and projections are based on what are known as "Type II" Multipliers – which the author states "average about 2" in California. Therefrom, the author assumes an X2 local multiplier effect for projected additional local business activity (and local revenues) generated when the City gets its goods and services locally.

- *Problem: There seems to be no such multiplier effect figured into the report projections for non-local contracts. It would be helpful to know how the following would inevitably change the projections in the reports:*
  - *a) The multiplier effect can vary significantly depending on the goods/services contracted for, and depending on many other variables. More detailed information would be very useful.*
  - *b) Many non-local contracts still may have some sort of local multiplier effect. (For example, a non-local consulting firm may have local subcontractors, or tile purchased out of L.A. would still require local handling and installation).*

ii. <u>Subsequent Reports</u> -- In the 3 subsequent versions of the Report, the author projects an additional 1.147 cents in revenues to the City from a local contract (from all sources other than business tax). The author further estimates another 2.25 cents in sales tax from resulting employment. Adding in other factors, the author concludes the City would get a revenue gain of 3.92 cents for each dollar of local contracting – plus another 1 cents (or 1%) – approaching a total of 5%. Again based thereupon, the author postulates a 5% local preference might be of potentially no cost to the City.

- *<u>Problem</u>: Same as for the Initial Report.*

C. Gross Receipts Tax –

i. <u>Initial Report</u> -- The initial U.S.C. Report's calculations and projections appear to be based on a tax rate of .4% for local businesses contracted to provide goods/services to the City, with none calculated for non-local businesses. This is also the underlying basis for the X2 multiplier effect calculated when the City contracts with local businesses.*

- *<u>Problem</u>: The following factors would inevitably change the projections in the Initial U.S.C. Report:*

  a) Non-local businesses <u>are</u> required to pay local Gross Receipts Tax on revenues generated from work in L.A.
  b) Only one of nine businesses tax categories in L.A. pay in excess of .356%, and most pay under .2% (<u>See table</u>). There are also various exemptions where a business may pay no tax. Basing projections on a .4% tax could result in very different estimates of the benefits of local contracting.
  c) If the Gross Receipts tax is cut or phased out the estimates could be quite different.

ii. <u>Subsequent Reports</u> -- In the 3 subsequent versions of the Report, the author uses an average gross receipts tax rate of .0022.

- *<u>Problem</u>: As above for the initial Report, and there is no explanation for either rate or for why the 2010 and 2011 reports use different rates.*

D. "Bid inflation" and competition –

- *<u>Problem</u>: How might the calculations and projections take into account certain unintended consequences that could increase the costs to the City of goods and services it procures? Specifically:*

  i. Competition could decrease, causing "bid inflation", when non-local bidders opt to not bid because they determine that they cannot afford to compete with an 8% local bid preference. This could particularly chase away non-local bids for goods/services from businesses with low profit margins.

  Qiao, Y., Thai, K., and L. Cummings (2009). "State and Local Procurement Preferences: A Survey". Journal of Public Procurement (9): 371-410: The survey indicated that local governments believed prices on average slightly increased due to bid preferences. (It is important to note that respondents were asked about price inflation due to all types of preferences (gender, ethnicity, disabled, etc) and not just local preferences).

ii. Non-local businesses currently providing goods/services to the City may find a local partner to submit future bids in excess of what the City is currently paying. If the local partner now gets the award based on an up to 8% preference, one of the main beneficiaries could very well be the non-local business now partnered with the local one. There are some anecdotal reports that some non-local businesses are looking into just such a strategy in anticipation of a new City local preference ordinance.

E. Reverse auctions *– This process is becoming an increasingly popular method of getting the best deal on goods and services. While this issue was not addressed in the July 2010 U.S.C. Report, its author added references thereto in subsequent versions of the Report. It remains somewhat unclear, however, how a local business preference would impact the effectiveness of employing reverse auctions.*

F. Mitigating considerations *– Each of the questions/issues hereinabove could adversely impact the City if a local preference of 8% (or some other percentage) turns out to be more expensive to the City's budget than the benefits therefrom. However, certain other calculations and projections might positively impact the cost/benefit analysis. The following are not currently included in the calculations and projections, but may be worthy of consideration:*

i. For purchases of goods, the City pays sales tax. Approximately 1% of the purchase price comes back to the City for purchases made locally, plus additional benefits from that portion of the sales tax that goes to local transportation, law enforcement, etc.;
ii. When local businesses realize more revenues, they make improvements and expand their places of business – which results in increased L.A. Dept. of Building & Safety permitting fees;
iii. Expanding businesses mean more property tax revenues for the City of L.A.; and
iv. As local businesses buy more equipment, machinery and supplies, they pay more Personal Property Tax Assessments to the County -- a portion of which is shared with the City.

APPENDIX "B"

L.A. County / City Sales and Use Tax Rate: (tax rate):

The City of Los Angeles pays sales tax on nearly every good it purchases (As of July 1, 2011, L.A. County's rate is 8.75%). This likely translates into well over $100 million in sales tax paid by the City each year for its purchases. Generally, for purchases made in the City of L.A., 1% of the purchase price (or about 11% of the sales tax paid) is distributed to L.A. for the benefit of its General Fund. The City also benefits from another 1.5% of the purchase price (or about 29% of the sales tax paid) that goes to the County for transportation (including Measure R money).

Rate	Jurisdiction	Purpose	Authority
3.6875%	State	Goes to State's General Fund	Revenue and Taxation Code Sections 6051, 6201
0.25%	State	Goes to State's General Fund	Revenue and Taxation Code Sections 6051.3, 6201.3 (Inoperative 1/1/01 – 12/31/01)
0.25%	State	Goes to State's Fiscal Recovery Fund, to pay off Economic Recovery Bonds (2004)	Revenue and Taxation Code Sections 6051.5, 6201.5 (Operative 7/1/04)
0.50%	State	Goes to Local Public Safety Fund to support local criminal justice activities (1993)	Section 35, Article XIII, State Constitution
0.50%	State	Goes to Local Revenue Fund to support local health and social services programs (1991 Realignment)	Revenue and Taxation Code Sections 6051.2, 6201.2
1.0625	State	Goes to Local Revenue Fund 2011	Revenue and Taxation Code Sections 6051.15 and 6201.15
1.00%	Local	0.25% Goes to county transportation funds 0.75% Goes to city and county operations	Revenue and Taxation Code Section 7203.1 (Operative 7/1/04)
Subtotal:			
7.25%	State/Local	Total Statewide Base Sales and Use Tax Rate	
L.A. County Add-on:			
1.50%	Local Add-on	For transportation (including 0.50% for Measure R)	
Total:			
8.75%	State/Local	Total Statewide Base Sales and Use Tax Rate – and L.A. County local add-on	

SOURCE: http://www.boe.ca.gov/news/sp111500att.htm

Appendix "C"

Survey * of Selected Local Preference Programs

Local Business Preferences Nationwide

See: Long Island Index[iv]*

City of Anaheim

Local Preference - Vendors located within Anaheim city limits are given a 1% pricing allowance when calculating the lowest responsive bid due to the ultimate receipt by the City of a proportionate return of sales tax.

City of Burbank

City Code Sec. Section 2-2-122 J - Purchasing Code: Based on "payment of local sales or use taxes that will accrue to the City," Burbank has a 1% local preference for taxable purchases, related to determining the lowest responsible bidder.

City of Calabasas

Title III, Chapter 3.4 of Calabasas Muni Code – Awards of Contracts to Businesses Located in the City: "The City shall give preference to businesses located in the City ("local businesses") when the difference between the bids from Calabasas businesses and those outside the City is less than the current sales tax benefit the City would receive from local sales tax and the local business will be able to provide goods or services which are equal in quality..." (See: http://www.cityofcalabasas.com/pdf/agendas/council/2010/042810/item3-staff-report.pdf).

City of Camarillo

City Code, Subsection 6 – Vendor Relations: "When feasible to do so, vendors within the City of Camarillo should be utilized for supplies, services and equipment."

City of Cerritos

City Code Sec. 3.20.065 – Granting Local Business Preference: "A local business which responds to a bid solicitation by the City of Cerritos for the purchase of equipment, supplies or services required for public use shall be granted a credit of 1% of its submitted bid in the city's determination of lowest and most responsible bidder."

City of Downey

Municipal Code Sec. 2910 – Local Vendor Preference: (a) For the purpose of calculating the lowest responsible bidder, vendors whose business or sales office or place of manufacture is located in the

City of Downey shall be given a (3%) percent credit in their bid in order to reflect the advantages that accrue to the City by the award of a bid to a local vendor. (b) This section will apply only to purchases of greater than an amount established by City Council resolution.

City of Long Beach

Municipal Code Sec. 2.84.030 – A bid from a Long Beach vendor for furnishing materials, equipment, supplies and non-professional services shall be reduced by 10%. In no case shall the maximum preference under this section exceed $10,000 for any bid.

City of San Diego

So-called bid discounts of up to 5% and up to a maximum of $50,000 for qualified Small Local Business Enterprises and Emerging Local Business Enterprises.

City of San Jose

Bids for goods and services from businesses located in Santa Clara County will now be viewed more favorably than non-local competitors while still including factors such as cost and experience. Small businesses with 35 or fewer employees will also benefit. For bids on goods, local businesses will have a 2.5% cost advantage and small, local companies a 5% cost advantage. In reviewing services provided through a request for proposal process local businesses will receive a 5% point advantage and small, local companies a 10% point advantage.

City of Thousand Oaks

Municipal Code Article 5, Chapter 10, Title 3 – Purchasing: Bid Evaluation Procedures: "Quality and service being equal, a local preference of five (5%) percent but not more than Five Thousand and no/100th *($5,000.00) Dollars shall be given to local vendors…."
http://www.toaks.org/civica/filebank/blobdload.asp?BlobID=20638

* *C.O.R.E. thanks the ShopLA Team of the Mayor's Office for its assistance in compiling comparison information.*

** *The Long Island Index was compiled by prepared based on data compiled by the Center for Governmental Research (CGR). New York State research was based on telephone interviews with purchasing agents and/or public works staff. A Lexis search engine review was conducted to identify all state statutes referring to public bidding and preferences. (See http://www.longislandindex.org/).*