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Annual Privatization Report 2016

State Government Privatization

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(Note: Portions of this report have been published previously in various editions of Reason Foundation's *Privatization and Government Reform Newsletter* and related articles.)

A. State Budget Update

States continued to slowly recover from the Great Recession in FY 2016, with aggregate state revenues increasing for the seventh straight year since FY 2010. Further, budget deficits have generally been small and manageable, in contrast to the years immediately following the onset of the recession. Despite the continuing trend of slow and steady economic recovery, several recent reports have suggested that significant challenges continue to face state budgets.

First, in the spring of 2016, the National Association of State Budget Officers (NASBO) issued its latest *Fiscal Survey of the States*, which found that in FY 2016, total state expenditures and revenues finally surpassed their pre-recession peaks seen in FY 2008, after adjusting for inflation. Yet, the recovery has been uneven across the states. FY 2016 general fund revenues remain below FY 2008 figures in 23 states, while FY 2016 general fund expenditures were lower than FY 2008 levels in 29 states.¹

Among the report's findings:

- State general fund spending surpassed pre-recession highs for the first time in fiscal year (FY) 2013 and is expected to end FY 2016 at 1.2% higher than the pre-recession peak after adjusting for inflation.
- Aggregate general fund spending in FY 2016 rose \$797.7 billion, a \$46.1 billion (or 5.5%) increase over FY 2015 levels. This is a larger increase than the 4.2% spending growth seen in FY 2015.
- Overall state spending levels are expected to increase by 2.5% to \$818.0 billion in FY 2017, a slower pace than the 5.5% growth experienced in FY 2016.
- At the time of the report's release, a total of 21 states had closed \$10.8 billion in budget deficits in FY 2016, with eight states reporting a need to close an aggregate \$8.9 billion in additional deficits by the end of FY 2016. A total of 19 states projected a combined total of \$19.7 billion in budget deficits to close in FY 2017.
- For FY 2017, 36 states proposed increased general fund spending for K-12 education by \$8.9 billion, 32 states proposed increased Medicaid spending by a net \$7.6 billion, and 35 states proposed increased higher education spending by a net \$1.1 billion. Further, 33 states propose increased corrections spending, and seven states propose transportation spending increases.
- State general fund revenues are projected to increase by 2.9% to \$810.1 billion in FY 2017, roughly equivalent to the 2.8% gain estimated for FY 2016.
- For FY 2017, a total of 13 states proposed net tax increases of \$5.4 billion, and another 15 proposed net tax decreases of \$2.1 billion.
- Ending account balances and the amounts in budget stabilization (e.g., "rainy day") funds combined fell from \$77.7 billion (10.3% of general fund expenditures) in FY 2015 to \$68.9 billion (8.9% of general fund expenditures) in FY 2016. Rainy day fund balances alone increased in FY 2016 to \$49.3

billion (6.5% of general fund expenditures), up from their FY 2015 level of \$45.1 billion (6.3% of general fund expenditures).

Despite the improved fiscal conditions, the report suggests that states will continue to face short- and long-term fiscal challenges. “Spending requirements on K-12 education, health care, and other critical areas continue to grow, often faster than state revenues,” according to NASBO.² “Some states are also facing unfunded pension liabilities, pent-up demand for infrastructure spending, and negative fiscal impacts from the decline in energy prices.”

Next, in November 2016 the Pew Charitable Trusts released an analysis finding that by the end of the first quarter of 2016, tax revenue collections in 31 states had rebounded to their pre-recession peaks.³ In aggregate, states took in 6.5% more tax revenue (after adjusting for inflation) in the first quarter of 2016 than they did in the third quarter of 2008 before receipts began to fall.

However, the analysis finds that the recovery has been uneven:

- Tax receipts were over 15% higher than the pre-recession peak in eight of the 31 states where tax revenues have rebounded.
- Of the 19 states where tax revenues have not yet rebounded, four states—Alaska, Florida, Louisiana and Wyoming—are still seeing tax receipts down by over 15% relative to their previous pre-recession peak levels.
- Of the 31 states where tax revenues have rebounded from their previous pre-recession peak levels, eight states—California, Colorado, Hawaii, Iowa, Maryland, Minnesota, North Dakota and Oregon—are seeing tax receipts over 15% higher.
- Five states—Illinois, New Mexico, North Dakota, Oklahoma and Texas—have experienced at least a full year of declining tax revenue as of the end of the first quarter of 2016.

Further, Pew notes that in aggregate, the states have 6.5 cents more in purchasing power for every dollar they collected before the pre-recession peak in 2008. However, Pew notes that despite this increased purchasing power, policymakers nonetheless “face budget pressures because of increased expenditures due to population growth, changes in Medicaid costs and enrollment, and deferred or new needs for schools, safety-net programs, corrections, employee salaries and pensions, and road maintenance and construction.”⁴

Next, NASBO released its latest *State Expenditure Report* in November 2016, which found that total state expenditures grew by 4.0% in FY 2016, much more slowly than the 6.9% increase in FY 2015.⁵ One primary cause was a reduction in federal funds to states that year. Other findings from the NASBO report include:

- In terms of total state expenditures (which includes federal funds), the top five spending categories in FY2016 were Medicaid (29%), K-12 education (19.4%), higher education (10.2%), transportation (7.9%) and corrections (3.0%).

- In terms of the expenditure of state funds only (general funds and other state funds, excluding bonds and federal funds), the top five spending categories in FY2014 were K-12 education (24.7%), Medicaid (16.8%), higher education (13.4%), transportation (7.5%), and corrections (4.4%).

Looking forward, the NASBO report suggests that while fiscal conditions are improving, “[s]tates will continue to work to ensure that budgets are structurally balanced and sustainable, while contending with increased spending demands, pressures from long-term obligations, volatility in state revenues, uncertainty surrounding federal fiscal policies, and moderate economic growth.”⁶

Last, the Government Accountability Office (GAO) offered a sobering fiscal assessment in the December 2015 edition of its *State and Local Governments’ Fiscal Outlook*, which found that both state and local governments will continue to face long-term fiscal imbalances, with a growing gap between revenue and spending through the year 2064, absent significant policy changes.⁷

GAO estimates that taking steps to close the looming fiscal gap today would require reducing overall state and local government expenditures by 5% and then holding spending essentially flat as a percentage of GDP for decades to come. While that gap is indeed significant, that figure is down significantly from the 18% needed reduction cited in the 2014 edition of the *Fiscal Outlook*, indicating an improving forecast.

The GAO attributes the long-term fiscal challenges primarily to “the rising health-related costs of state and local expenditures on Medicaid and the cost of health care compensation for state and local government employees and retirees.”⁸ In fact, the report projects that state and local health care expenditures are likely to increase at a faster rate than GDP through 2064. State and local pension obligations—specifically, the growing mismatch between pension assets and liabilities over the past decade—is another factor cited by the GAO as a potentially important impact on the state and local fiscal outlook.

Overall, these reports suggest that while a fiscal recovery is well underway at the state level, significant challenges remain, particularly in areas like pensions, infrastructure and employee health care. This will place continued pressure on policymakers to find new ways to lower the cost of service delivery and reform underfunded retiree benefit structures, among other policy goals.

B. Higher Education Public-Private Partnerships Update

Higher education is the third largest category of state spending after Medicaid and K-12 education, accounting for an estimated 10.2% of total state expenditures in FY 2016, according to the National Association of State Budget Officers.⁹ And though state budgets are continuing a slow recovery from the Great Recession, state university systems are becoming more reliant on tuition and fees and less reliant on state general fund appropriations given the relatively faster growth of Medicaid and K-12 education spending, and thus, more competition for state general fund dollars.

The trend toward increasing fiscal self-sufficiency and the persistent need to modernize campus facilities has prompted university systems to find creative ways to engage the private sector through various types of public-private partnerships (PPPs), which span a broad range from outsourcing operational and administrative services to tapping private financing, operations and maintenance for new university facilities. The National Council of Public-Private Partnerships identifies 18 different types of PPP agreements currently used in higher education.¹⁰ Such PPP models help reduce operating costs, better maintain existing facilities, and develop new and modernized academic buildings, dormitories and other campus facilities.

Noteworthy developments on higher education PPPs over the past year include:

Arkansas: In February, Arkansas State University announced a 35-year lease agreement with Zimmer Development to build two student housing projects—a 350-bed undergraduate facility and a 165-bed facility primarily for graduate students—in the school’s first PPP.¹¹ In June, the university broke ground on the two projects.¹² In addition to construction, Zimmer will maintain the projects over the lease, which will also include \$305,000 in annual payments to lease the land in the agreement’s early years, after which ownership of the buildings will be transferred to the school. Management and marketing of the housing will be handled by the school.¹³

“We studied our options and concluded that the most efficient, the most responsible path for both our students and the taxpayers who support us was to forge a public-private partnership to expand our on-campus housing,” ASU Chancellor Tim Hudson said. “After careful consideration of the groups that responded to our request for proposals, we selected Zimmer Development to work with us.”¹⁴

Along with the housing PPP, Arkansas State sought a partnership with O’Reilly Hospitality Management to develop a hotel and conference center for the school’s campus, but the Jonesboro Advertising & Promotion Commission voted 3–2 against a measure to contribute funds to the project in March, opting instead to fund an off-campus hotel and conference center project for the city of Jonesboro.¹⁵

California: This August, the University of California-Merced reached financial close on a \$1.4 billion PPP that will facilitate a near-doubling of the size of the UC system’s youngest campus by the end of the decade, an important project for a campus quickly approaching the physical capacity of its current facilities.¹⁶ The

university is partnering with a consortium backed by the Plenary Group to deliver a mixed-use development combining academic, administrative, research, recreational, residential and student-services facilities sufficient to accommodate 10,000 students by the 2020–2021 academic year. It will be developed across a 219-acre university-owned site that includes the current campus and 136 acres of adjacent, undeveloped land.¹⁷

The Plenary-led consortium will be responsible for raising all private financing, designing and building all of the new facilities as a single project, and for ensuring the operations of major building systems over the 39-year contract term. The new buildings will also be in compliance with the university's environmental sustainability objectives, which include goals of zero net energy usage and carbon emissions, as well as zero landfill waste by 2020.¹⁸

Florida: Last November, the state's Board of Governors approved plans by the University of South Florida to partner with Capstone Development and Harrison Street Real Estate Capital in a \$133 million PPP to replace an older student housing development with a new mixed-use complex that will provide housing, dining, health and recreational facilities.¹⁹ The school hopes to have construction completed by mid-2018.

Indiana: Purdue University and the city of West Lafayette broke ground in June to start the construction phase of its State Street Redevelopment Plan, a PPP with Plenary Roads State Street.²⁰ In March, Gov. Mike Pence approved the \$120 million deal, allowing it to move forward.²¹ The project includes significant restructuring, beautification and safety improvements to the roads of Purdue's campus and a large portion of the city of West Lafayette, with a completion date expected before 2018, in time for the university's 150th anniversary celebration.

Iowa: The University of Iowa and Balfour Beatty reached financial close for Phase 2 of its Aspire at West Campus housing project in May 2015. The \$34 million PPP adds living space for over 400 students, and is expected to open this fall.²² Phase 1 of the project was completed in August 2014.²³

Kansas: Lawmakers sought to end The University of Kansas' (KU) \$327 million Central District development project PPP in budget negotiations this February but backed down, instead reaching an agreement with Gov. Sam Brownback in May that will require legislative approval of future PPPs by most state agencies.²⁴

Though ultimately spared, the Central District project's financing structure raised the ire of state officials. The project was financed largely through the issuance of bonds by a Wisconsin agency to a university-created nonprofit, preventing the need for approval by the Kansas Legislature.

With the legislation, the state legislature may directly approve contracts of less than \$5 million. Projects between \$5 million and \$25 million require filings with the State Building Advisory Commission and the Joint Committee on State Building Construction, with final approval coming from the State Finance Council. The legislation also created a Commission on Public-Private Partnership Building Projects to develop

guidelines to assess partnerships and their feasibility, as well as recommendations on when such arrangements are appropriate.²⁵

Separately, a December 2015 housing study conducted for Wichita State University recommended the school build a new residence hall, with a PPP being one of two possible delivery methods.²⁶ Earlier in that year, the university delayed plans for a new residence hall scheduled to start construction in November.²⁷

Kentucky: In March, Eastern Kentucky University chose F2/GC, a joint venture of F2 Companies and Grand Campus Properties, to act as developer for the school's first PPP. F2/GC will build two residence halls in the deal, while receiving title to land and a future pedestrian bridge connecting the campus to an existing Grand Campus-managed housing complex, which sits just west of the campus.

Louisiana: This February, the LSU Property Foundation selected RISE Real Estate as its preferred bidder for a PPP to design, build, finance, operate and maintain the Nicholson Gateway Development Project, as well as the possible renovation of six existing campus residence halls.²⁸ The project, expected to rely solely on private financing, will include 1,260 apartment-style beds and 410 suite-style beds with associated residential support spaces, as well as 30,000 to 50,000 square feet of new retail space, on a 28-acre site adjacent to the main campus.²⁹

Massachusetts: In February, UMass selected Capstone Development Partners as its preferred bidder to construct on-campus housing for its Boston campus. To construct the \$120 million project—a 260,000 square-foot residence hall—Capstone will lease a portion of the campus.³⁰ The school will maintain security and student life at the residence hall, which is expected to house around 1,000 students.

Michigan: Eastern Michigan University (EMU)'s Board of Regents approved a 10-year contract with Chartwells Higher Education to provide the school's food services in a PPP.³¹ In the agreement, Chartwells provides \$18 million in capital as well as a \$5 million signing bonus for EMU. The privatization took effect in July.³²

Northern Michigan University looks to privatize some of its services, too, as administrators seek to cut the school's budget by \$2 million. In February, NMU's Board of Trustees voted unanimously to enter into a contract with Barnes & Noble to run the school's bookstore. NMU looks to boost sales with the contract, as well as access much-needed capital to improve the bookstore.³³

In August, NMU broke ground on a new campus residential community, which will be developed, financed, constructed and managed by EdR in a 75-year lease agreement. The \$80 million dorm project aims to expand on-campus residence by over 1,200 students during the 2017–2018 academic year.³⁴

Ohio: The Ohio State University (OSU) announced plans in February 2016 to move into the third and final phase of an initiative seeking a potential 50-year lease of the university's energy system operations after receiving responses from 10 consortia to a December 2015 request for information (RFI). OSU currently spends \$100 million per year on energy and faces at least \$250 million in needed energy efficiency projects,

prompting the pursuit of a PPP to reduce energy spending and tap private financing for costly efficiency upgrades, which would allow the university to redirect resources toward supporting its core academic mission. As of August, OSU had selected six of the 10 RFI respondents to participate in an upcoming request for proposals, hoping to select a bidder by year-end or early 2017.³⁵

In June, Cleveland State University issued a request for qualifications, seeking firms interested in a potential long-term concession to operate and upgrade the university's 4,100-space parking system. The university is seeking to maximize the value of its parking assets while addressing a shortage of parking spaces amid rapid growth in enrollment. Qualifications were due in mid-July; at press time the university had not taken further action.³⁶

In February 2015, Gov. John Kasich signed an executive order calling for the creation of the Ohio Task Force on Affordability and Efficiency in Higher Education to identify ways state higher education institutions can reduce costs.³⁷ In October 2015, the task force delivered a set of recommendations to the governor's office that include having each institution analyze its non-core assets to determine their market value if sold or leased, as well as identify non-academic operations that might be run more efficiently by an outside entity (e.g., dining, housing, parking, facility maintenance, landscaping, etc.).³⁸

North Carolina: In April, the University of North Carolina's flagship Chapel Hill campus selected Barnes & Noble Education Company to operate its student bookstores. All 48 current full-time employees will continue to be employed at the same level of pay or greater, for a minimum of three years.³⁹ Barnes & Noble expects the deal will generate annual payments to the university of at least \$3 million—guaranteed as a minimum payment by the company for the first two years—and after debt and other school expenses, will generate nearly \$2 million annually for needs-based scholarships.⁴⁰

South Carolina: In October 2015, the University of South Carolina sought a developer to design, build, finance, operate and maintain new housing towers on the south of its campus, as well as dining, parking and study facilities. An RFQ released the previous month called for the selected developer to lease a roughly 20-acre parcel from the university for up to 40 years, paying the school a base rental fee, with the two parties sharing the profits.⁴¹ The plans called for the school to issue an RFP once after shortlisting potential firms, but the school reported no further developments as of press time.

Tennessee: The University of Tennessee announced last December that it is extending its dining contract with Aramark by five additional years, pushing the termination date to June of 2027. The university will receive over \$15 million and a 14% commission through 2027, using those revenues to fund campus renovation and construction projects.⁴² The Aramark contract began in 1997, was rebid in 2007, and is now on its second five-year extension. In an interview with the *Knoxville News-Sentinel*, University of Tennessee Senior Associate Vice Chancellor for Finance and Administration Jeff Maples said of the Aramark contract, "After 18 years, we think this has served the university well."⁴³

Texas: In July 2015, officials at Texas A&M University announced that it had selected Servitas, LLC and NCCD-College Station Properties LLC to develop a 48-acre property in College Station for student housing

in a 30-year lease that will pay the university \$18.5 million up front and a revenue stream of \$20 million annually.⁴⁴ The project—Park West—is the largest of five recent PPPs Texas A&M has advanced in recent years, which are collectively expected to generate more than \$900 million in benefits to the university.⁴⁵

“Every extra dollar we can generate or save is one less dollar from the students, their parents or Texas taxpayers,” said Texas A&M University System Chancellor John Sharp in a press release. “Besides the revenue it generates, the Park West project also puts the debt and the risk on the books of the private sector, not with the A&M System.”⁴⁶

C. State Liquor Privatization Update

A total of 33 states have chosen to regulate the private distribution and sale of distilled spirits through licensing and other requirements since the end of Prohibition in 1933. The remainder—known as “control” states (along with two Maryland Counties)—maintain some form of government-owned wholesale and/or retail monopoly in the distilled spirits market, as shown in Table 1.

State	Retail			Wholesale	
	Government Operated	Agency/Contract	Fully Privatized	Government Operated	Contract
Alabama	X		X	X	
Idaho	X	X		X	
Iowa			X	X	
Maine		X			X
Michigan			X	X	
Mississippi			X	X	
Montana		X		X	
New Hampshire	X	X		X	
North Carolina	X			X	
Ohio		X		X	
Oregon		X		X	
Pennsylvania	X			X	
Utah	X	X		X	
Vermont		X		X	
Virginia	X			X	
West Virginia			X	X	
Wyoming			X	X	
Local					
Maryland - Montgomery Co.	X			X	
Maryland - Worcester Co.	X			X	

The composition of the markets for the distribution and sale of distilled spirits has largely been static since the end of Prohibition, though shifts during that time have exclusively gone in the direction of privatization, not government control. No state has ever shifted from a private regime to a state-run liquor monopoly, and there is also a significant degree of privatization in some “control” states already. For example,

- In November 2011, Washington State voters approved a ballot measure that fully privatized the state-run wholesale and retail spirits monopolies.
- Iowa and West Virginia fully privatized their spirits retail monopoly in recent decades, retaining their in-house wholesale operation.
- Maine has outsourced the operation of its spirits wholesale monopoly to a private manager since 2004.
- Five states—Maine, Montana, Ohio, Oregon and Vermont—use an “agency/contract store” model in which the operation of state-owned retail liquor stores is contracted out to private operators, while three others—Idaho, New Hampshire and Utah—use a blend of state-owned and operated retail outlets and agency/contract stores.

1. State Liquor Privatization Roundup

Noteworthy developments in liquor privatization over the past year include:

Alabama

For the third time in three years, State Sen. Arthur Orr introduced legislation to privatize Alabama's liquor retail monopoly that failed to advance to a floor vote. The legislation—Senate Bill 292—would have shuttered 20% of the state's owned and leased retail establishments each year for five years.⁴⁷ The bill was assigned to the Senate Committee on Fiscal Responsibility and Economic Development, but it failed to receive a vote. “We currently have the government in competition with the private sector, an area I would argue is not necessarily a function of government,” Orr told the *Lagniappe Weekly* in March.⁴⁸ “Plus, we're looking at substantial cost savings of anywhere between \$4 million to \$6 million on the low end, but I've seen numbers as high as \$40 million.”

Oregon

For the second time in two years, Oregonians for Competition—a group backed by the Northwest Grocery Association—withdraw a proposed ballot measure in April 2016 to end the state-run liquor monopoly and abolish state liquor taxes. Proponents opted to step back from the privatization push to focus their energies on defeating a ballot measure seeking to increase corporate taxes. The group vows to continue their efforts in the future, unless the legislature were to act or the state's Liquor Control Commission decides—as it did on a very limited basis in the Portland area—to allow the sale of distilled spirits in grocery stores.⁴⁹ In 2014, Oregonians for Competition advanced two separate ballot initiatives on liquor privatization, but legal issues prompted them to withdraw in advance of the signature-gathering deadline in June 2014.⁵⁰

Pennsylvania

Legislation to privatize Pennsylvania's liquor wholesale and retail liquor monopolies was approved by the House and died in the Senate multiple times during the 2013–2014 legislative session, but the 2015–2016 session saw a very different outcome.

In late June 2015, the Senate voted for the first time to approve liquor privatization legislation, sending House Bill 466 back to the House for concurrence and eventual passage. This marked the first time since Prohibition that the General Assembly sent a sitting governor legislation designed to end the Commonwealth's status as a control state. Among its provisions, HB 466 would have phased out state-operated liquor stores, divested the state's liquor and wine wholesale enterprise, authorized holders of beer retail licenses (e.g., grocery stores, restaurants, bars, hotels, etc.) to pay additional fees to sell wine, and allowed wine and liquor importers to purchase new wholesale licenses. Gov. Tom Wolf vetoed the bill the day following the House vote.

The House made another attempt later in the year amid budget negotiations, sending a similar bill (House Bill 1690) to the Senate for consideration in November. However, by that point support for full privatization had languished among Senate Republicans, and the bill became a vehicle for a much less ambitious—but nonetheless substantial—reform that was signed into law in June 2016.

While it ultimately left the state-owned liquor wholesale and retail monopolies intact, HB 1690 authorized grocery stores, hotels and restaurants to sell wine, allowed direct wine shipments to homes, expanded the hours of state-owned liquor store operation, and granted the Pennsylvania Liquor Control Board greater flexibility in pricing. House Speaker Mike Turzai—sponsor of HB 1690 and the 2013 House privatization bill, and perhaps the leading privatization advocate in the General Assembly—described the legislation as a solid first step and speculated that the new law “will accelerate public demand for full privatization.”⁵¹

In November 2016, House Majority Leader Dave Reed suggested that the idea of full privatization might return in the 2017–2018 general session. “Wine privatization has gone off very well to meet people’s expectations,” Reed told *The Patriot-News*.⁵² “We could take that the rest of the way over the goal line and pick up a couple hundred million dollars.”

Utah

Utah’s reach into the alcohol market is the most extensive among the control states—its state-owned wholesale and retail monopoly covers distilled spirits, wine and beer over 4% alcohol—but two separate polls in 2016 found significant public support for privatizing the state’s alcohol monopoly.

In January 2016, the *Salt Lake Tribune* and Hinckley Institute of Politics released a poll of Utah voters finding that a 57% majority support liquor privatization, with 34% opposed and 9% undecided.⁵³ Clear majorities of Democrats and independents supported privatization—70% and 59%, respectively—along with a 49% plurality of Republicans. When broken down along religious lines, Mormons were roughly split on the question—45% expressed support for privatization, while 46% opposed. By contrast, 75% of non-Mormons supported privatization, compared to 18% opposed.

In October, a poll by Dan Jones and Associates found 49% support for privatizing alcohol sales; 37% of respondents opposed the idea, while 13% didn’t know.⁵⁴ A majority of Democrats (75%) supported privatization, compared to only 34% of Republicans and 61% of independent voters. Meanwhile, 50% of Republicans prefer the status quo of state control, compared to 28% of independent voters and 19% of Democrats. The survey also found that 47% of “very active” Mormons oppose privatized alcohol sales, while 33% support privatization and 19% did not yet have an opinion.

While relatively popular among voters, the idea of privatizing the state’s alcohol monopoly has never gained traction in the legislature, much to the chagrin of State Sen. Jim Dabakis, who announced plans to pursue, through his political action committee, a ballot initiative that would eliminate the Utah Department of Alcoholic Beverage Control and dismantle the state’s alcohol monopoly if the legislature failed to act in the

2016 session. “State control of the economy doesn't work in North Korea and it doesn't work in Cuba,” Dabakis told reporters in July.⁵⁵ “It's a model that simply isn't there and guess what? State control of alcohol in Utah isn't working.”

Washington State

In June 2016, Washington State entered the beginning of its fifth year of privatized sales and distribution of distilled spirits, after becoming the first state since the end of Prohibition to fully abandon the control state model. In November 2011, voters approved Initiative 1183 (I-1183), which fully privatized the state's wholesale enterprise and privatized its nearly 330 retail outlets. Today, approximately 1,500 stores hold licenses for spirits sales, primarily large outlets like grocery stores, wholesale clubs, and national alcohol retail chains. Also, in opening up the wholesale market to competition, I-1183 allowed retailers to buy spirits and wine directly from manufacturers or wholesalers; retailers are still legally required to purchase beer from wholesalers.

Despite a smooth transition to privatization overall, there has been significant price volatility in the wake of privatization, in part due to the imposition of new liquor fees under I-1183—a 17% retail license issuance fee on retail sales and a two-year, 10% distributor license issuance fee on wholesalers (subsequently reduced in 2014). According to data compiled by the Washington State Department of Revenue (see Table 2), the average price per liter of spirits has increased by 16.8% since the onset of privatization, from an average of \$20.78 in FY 2012 (the year before privatization) to \$24.28 in FY2016 (the fourth full year of privatization); the vast majority of this increase occurred in the first year of privatization, and increases in average price per liter have been fairly modest since then. Post-privatization price increases led to a commensurate 20% increase in spirits-related tax revenues from \$241.7 million in FY 2012 to \$289.8 million in FY 2017.

	Spirits-Related Tax Revenues (millions)	Percent Change from Previous Year	Spirits Sales (million liters sold)	Percent Change from Previous Year	Average Price Per Liter (after taxes)	Percent Change from Previous Year
FY2012	\$241.7	--	39.5	--	\$20.78	--
FY2013	\$267.0	10.5%	40.1	1.6%	\$23.13	11.3%
FY2014	\$267.7	0.3%	40.1	0.0%	\$23.29	0.7%
FY2015	\$276.3	3.2%	41.0	2.3%	\$23.71	1.8%
FY2016	\$289.8	4.9%	42.5	3.5%	\$24.28	2.4%

Notably, spirits sales have risen slowly since privatization, rising 7.5% from 39.5 million liters sold in FY 2012 to 42.5 million liters sold in FY 2016. This suggests that consumption-related fears raised by some privatization opponents—namely, that privatization would lead to dramatic spikes in spirits sales due to increased availability—have not borne out.

As with any major market upheaval, the changes brought by I-1183 have both defenders and detractors. The post-privatization price increases remain the main focal point of critics' ire, who often note that along with greater convenience and access to spirits has come higher prices, a decidedly mixed bag for consumers. Similarly, distillers lost connection to a state monopoly that guaranteed market access, but also received

much more flexibility and autonomy in marketing and market access (through the ability to open tasting rooms and the like).⁵⁶ Additionally, some wineries and smaller independent retailers have complained about I-1183's effects in the wine market; allowing for volume-based pricing is helping drive a trend toward less selection offered by larger retailers that entered the market, critics say.⁵⁷

D. State Privatization News and Notes

Alaska

In response to recent budget cuts, Alaska's Department of Natural Resources issued a request for proposals in February 2016 seeking one or more private operators for four state park units in the Valdez area. In June, the state was close to finalizing terms with Levitation 49, a nonprofit sports commission, to take over management and operations of outdoor recreation facilities located near the town, which were previously managed and funded by the state's Department of Natural Resources.⁵⁸ From earlier reports, Levitation 49 would be allowed to collect fees for cabin rentals, campsites and, possibly, daily parking and picnic shelters, while operating the parks similarly to the state's previous management, including facility maintenance and repairs, janitorial services, and reservation management and fee collection.⁵⁹ As of press time, final terms have not been released.

In January, the board of directors of the state-owned Alaska Aerospace Corporation recommended pursuing privatization, a move that would require legislative approval.⁶⁰ Privatization would likely require the corporation to pay the state back over \$30 million in state-funded operating and infrastructure expenses.⁶¹ The move would help facilitate the corporation's interest in diversifying beyond its current primary focus on rocket launches.

Arizona

In February 2016, the Arizona Department of Transportation (ADOT) announced it had finalized a contract with Connect 202 Partners to design and build the Loop 202 South Mountain Freeway—the largest-ever highway project in the state—and maintain it for 30 years after construction. Connect 202 Partners is a consortium consisting of Fluor Enterprises, Inc., Granite Construction Co. and Ames Construction, Inc., with Parsons Brinckerhoff, Inc. as the lead designer.

The \$916 million fixed contract for design and construction is \$122 million less than expected as a result of innovative approaches the private partner proposed for construction and engineering, along with reductions in needed property acquisitions. “This first-of-its-kind highway contract in Arizona has not only reduced the overall cost but allowed ADOT to accelerate the entire project, meaning motorists will be able to benefit from this critical freeway sooner,” ADOT Director John Halikowski said in a press release.

ADOT also finds itself in various stages of procurement for several other PPP initiatives, including a project to upgrade all lighting on freeways within the Phoenix maintenance district, a project to overhaul the freeway drainage system for Phoenix-area highways, and a PPP to finance and develop a mainline electronic truck screening system for the state's six major ports of entry.

In other Arizona news:

- In June 2016, the Arizona Department of Health Services issued an RFI for a PPP to better improve behavioral and mental health services at the Arizona State Hospital (ASH) by better utilizing the assets of the 93-acre campus in Phoenix.⁶² The move would not privatize state-delivered behavioral health services at ASH that are currently required by statute, but would instead seek private partners to use available property and/or buildings located on the hospital campus to enhance and improve the behavioral health services available to the community. The Department is open to a variety of PPP models for the project. While the RFI closed at the end of June, no updates were available as of press time.
- In April 2015, ADOT expanded a program that allows Arizona residents to obtain and renew driver's licenses and other traditional Motor Vehicle Division (MVD) functions in private establishments.⁶³ Since then, ADOT has added 12 more locations, bringing the total to 26 in early August.⁶⁴ While the third-party locations offer the same services as the MVD, extra charges mean the services cost more, but the tradeoff for reduced wait times and easier access have resulted in the third-party locations issuing around 10,000 licenses a month, of about 72,000 total, in a program initially started in April 2014.⁶⁵ The opportunity to provide the driver's license service requires extensive training by the state, as well as a minimum of two years of previously providing title and/or registration services, now provided at over 100 third-party locations across the state.⁶⁶
- Last July, Gov. Doug Ducey moved forward with selling off most of the state's airplane fleet, a move expected to save more than \$1 million in maintenance costs, the *Arizona Republic* reported.⁶⁷ In the move, which comes a few years after the state bought a \$4.5 million plane that Gov. Ducey was unable to cancel, the state will sell three of its planes for a combined \$800,000.⁶⁸

Arkansas

Last August, the Arkansas Department of Health announced that it plans to privatize its in-home services program in 2016, citing decreased revenue, declining patient loads and competition from the private sector over the last five years.⁶⁹ The program currently serves more than 13,000 patients, providing hospice, home health and personal care services.⁷⁰ "This is an example of a government program that is no longer sustainable and can be ended because the private sector has stepped in to meet demand," Gov. Asa Hutchinson said in a press release. "In the long run, this transition will preserve jobs, save taxpayer dollars and result in a more efficient, viable and sustainable in-home care program for Arkansans."⁷¹

In June 2016, the state sold its in-home services program to Kindred Healthcare, Inc. for close to \$39 million, which includes licenses for home health, hospice and personal care services.⁷² While a few final steps in the approval process remain, officials expect a final close by the end of September.

California

In February, Xerox backed out of its deal with the state to design a management information system for its Medicaid operations. The parties previously reached an agreement back in 2011 for Xerox to take over existing Medicaid operations while designing a new system. In the settlement, announced in April, Xerox will pay the state \$123 million and transfer its health care computer systems, valued at an additional \$15 million, back to the state.⁷³

In other California news:

- In October 2015, Gov. Jerry Brown signed into law Senate Bill 331, sponsored by Sen. Tony Mendoza. It requires any city, county or special district that has adopted a “civic openness in negotiating” (COIN) ordinance to comply with several new procedural hurdles related to contracts over \$250,000 that the government negotiates with any private parties seeking to provide public services or goods.
- That same month, Gov. Brown vetoed Senate Bill 376, introduced by Sen. Richard Lara. It would have prohibited the University of California system from contracting out full-time positions to companies that fail to provide total compensation (wages and benefits) equal to or better than those for in-house positions within the university system doing comparable work.
- Days later, Gov. Brown vetoed Senate Bill 682, sponsored by Sen. Mark Leno. The bill would have required trial courts to meet several strict standards if they move to contract out any services currently performed by that trial court’s employees. Among other things, the bill would have required the trial court to clearly demonstrate overall cost savings to the trial court from the proposed contract, as well as no net losses of current public employees. “[SB 682] requires California’s courts to meet overly detailed and in some cases nearly impossible requirements when entering into or renewing certain contracts,” Brown said in his veto message. “Other provisions are unclear and will lead to confusion about what services may or may not be subject to this measure.”

Colorado

In May, Governor John Hickenlooper signed legislation that sets up a pilot program to explore privatizing the state’s Department of Motor Vehicles.⁷⁴ In the program, the state will allow a private contractor to build and maintain kiosks to allow residents to conduct many functions related to driver and vehicle registration, including the issuance of titles and certificates, as well driver’s license and registration issuances and renewals. The pilot program will serve as a study to explore fuller privatization.⁷⁵

Connecticut

In early February, Connecticut Gov. Dannel Malloy introduced legislation aimed at reducing wait times experienced at the state Department of Motor Vehicles (DMV).⁷⁶ House Bill 5055 includes a provision that would allow the state to enter into contracts with private contractors to provide vehicle registration services.

“Long wait times experienced by customers at the DMV is simply unacceptable, and that’s why we’re outlining commonsense proposals to lower them,” Governor Malloy said in a press release.⁷⁷ “This enhanced flexibility best serves the customer, allows private contractors to conduct most routine motor vehicle transactions, and most importantly, decreases wait times at the DMV.”⁷⁸ The bill received a favorable report in late March and was placed on the legislative calendar, but as of press time, there were no further developments.⁷⁹

In March lawmakers introduced another bill, House Bill 5041, which goes so far as to require privatization of the DMV, though stops short of giving specifics on the extent of the privatization.⁸⁰ While the bill did receive a public hearing on March 16, as of press time, there was no further action.⁸¹

Georgia

After failing to receive a full House vote in 2014, social infrastructure PPP enabling legislation—authorizing state agencies, local governments, school boards and other governmental units to use PPPs to develop public infrastructure projects on government-owned or leased land—passed in the Georgia General Assembly in 2015. Gov. Nathan Deal signed the legislation, Senate Bill 59, the “Partnership for Public Facilities and Infrastructure Act,” in May 2015. The legislation also creates a Partnership for Public Facilities and Infrastructure Act Guidelines Committee to prepare model guidelines for governmental authorities to use in developing PPP projects. To help passage, bill sponsor State Senator Hunter Hill modified the 2014 legislation to address concerns raised over provisions related to unsolicited PPP proposals that private sector firms would be allowed to submit to state agencies.⁸²

Hawaii

A May 2016 court order by the 9th Circuit Court of Appeals will delay until September the plans for Hawaii’s privatization of three state-owned Hawaii Health Systems Corporation hospitals on the island of Maui, which are to be operated by Kaiser Permanente.⁸³ The Maui hospital system is currently losing \$42 million a year, and officials seek a PPP arrangement to address those financial concerns.⁸⁴

By the end of August 2016, no deal had been made between Kaiser, the state, and the employee unions, leading state officials to plan partial closings of hospital facilities until at least July 2017, the earliest date in which Kaiser will be able to handle the transition.

In April, judges had expressed concern over the fate of 500 state-employed United Public Workers (UPW) union members who are expected to lose their jobs, triggering the May court order. The move reverses a state court decision in February to not allow a challenge to privatization by UPW workers, who say the move would violate the U.S. Constitution’s contract clause. The state replied that it will comply with the court order and will work more to address worker concerns over the next year.⁸⁵

As a result of concerns from hospital employees, lawmakers called for a special legislation session in July.⁸⁶ During that session, the Hawaii Legislature overrode Governor David Ige's veto of a bill designed to preserve the pensions of workers affected by privatization.⁸⁷ Governor Ige saw the measure as greatly hurting the state's long-term fiscal health. Although the governor introduced alternate legislation designed to address those worker concerns, the state legislature, which voted to override the veto 43-3 and 18-4 in the House and Senate, respectively, took no action on the governor's proposal.⁸⁸ In late August, Kaiser Permanente announced that it would not be able to take over until July, 2017, leading to phased closures of hospital services on the island.⁸⁹

Idaho

In March, Gov. Butch Otter signed legislation (House Bill 538) developed by an interim legislative committee convened last fall that recodifies and updates the state's procurement laws and adds in new training requirements for all state employees involved in procurement activities. The legislation, formulated and passed largely in response to a 2014 state audit report that found several high-profile contracting problems in recent years, also requires the administrator of the state's division of purchasing to develop policies and procedures for agency contract monitoring, as well as establish a set of ethical standards applicable to anyone involved in state procurement.⁹⁰

Illinois

In late July, Gov. Bruce Rauner announced the state will seek bids from the private sector on a new contract to manage and operate the state lottery.⁹¹ As discussed in previous editions of Reason Foundation's *Annual Privatization Report*, the state's current contract with Northstar Lottery Services has been contentious and has not yielded the expected profit results, resulting in a legal dispute between the state and Northstar. The state hopes to have a new contractor in place next year, promising Northstar that it can continue to run the lottery until January, 2017.⁹² If a new manager cannot be found, the governor may seek to create a quasi-public entity managing the lottery, a move that would require legislative approval.

In February, Gov. Rauner issued an executive order requiring the state's economic development agency to work with a nonprofit to recruit business on the state's behalf.⁹³ Gov. Rauner had attempted to partially privatize the state's Department of Commerce and Economic Opportunity via legislation in late 2015, but that attempt stalled when language inserted in the bill would have required repeal of the PPP after three years.⁹⁴

Also in February, Gov. Rauner called for a PPP to widen a 25-mile stretch of Interstate 55 through the use of managed lanes, the *Joliet Herald-News* reported.⁹⁵ The affected area lies between Interstates 355 and 90/94, and receives 170,000 passengers a day. While the state has had PPP legislation on its books since 2011, the Illinois Department of Transportation (IDOT) has never completed a deal. That, combined with controversial asset lease deals involving the Chicago Skyway and the city's parking meters, leaves some lawmakers skeptical, and they must pass a resolution in support of the PPP before any procurement can start.⁹⁶ In

response, IDOT officials pointed to the fact that this project, unlike the leasing agreements, involves new construction, and any winning bidder would be required to complete a full lane before it could start collecting revenues.

Indiana

In May 2016, CalPERS, the retirement system for California's public workers and the largest public pension system in the U.S., purchased a 10% share of the company that operates the 157-mile Indiana Toll Road. "This solid, long-term investment represents our first foray into a transportation asset in the United States," said Paul Mouchakka, Managing Investment Director for CalPERS' Real Assets program, in a press release. The move came roughly a year after the Australian fund manager IFM Investors bought the bankrupt ITR Concession Company (ITRCC) for \$5.725 billion, which was previously managing the road under a 75-year concession agreement. IFM took over the remaining 66 years of the lease contract in 2015 and will be held to the same contractual performance and maintenance standards outlined in the original lease. ITRCC entered bankruptcy in 2014, citing an inability to make its debt payments due to lower-than-estimated toll revenues in the wake of post-recession traffic volume reductions.

In other news, the Indiana Supreme Court issued a long-awaited ruling in March 2016 in a dispute between the state of Indiana and IBM over the early cancellation of a 2006 contract to modernize the state's welfare eligibility system. That year, the state entered a 10-year, \$1.34 billion contract with IBM to automate eligibility determinations for food stamps, Medicaid and other welfare benefits, and to significantly reduce face-to-face interactions. However, a variety of implementation glitches ultimately prompted former Gov. Mitch Daniels to cancel IBM's contract in 2009, at which point the parties countersued.

Indiana did not abandon privatization, however; the state opted to implement a hybrid service delivery approach relying more on face-to-face contact while enhancing some of the previous technological improvements made by IBM. The state ultimately contracted with Xerox subsidiary Affiliated Computer Services (ACS)—IBM's primary subcontractor on the original privatization—in an eight-year, \$638 million service contract to implement the hybrid program.

The high court ruling upheld a court of appeals determination that the state could recover up to \$175 million in damages it is seeking from IBM, which the court found breached its contract, while at the same time allowing IBM to seek reimbursement for approximately \$50 million for services delivered under the contract. The original 2012 Marion County Superior Court ruling required the state to pay the reimbursement IBM sought on the grounds that IBM's poor performance did not constitute a breach of contract, as much of the hybrid program that followed was derived from IBM's original work on the modernization.

The state lost its countersuit to recover over approximately \$175 million from IBM, but in February 2014, the Indiana Court of Appeals largely reversed the superior court's ruling on the breach of contract, sending the case back down to the lower court to determine whether the state can recover all or some portion of the approximately \$175 million it is seeking from IBM. However, the appeals court also ruled that the state still owed IBM approximately \$50 million for services delivered under the contract.

Despite the high court ruling, the ongoing legal saga took yet another turn when a superior court judge tasked with deciding the amount of damages owed to the state issued a ruling in May 2016 that awarded no damages on grounds that the state had failed to prove its case against IBM.⁹⁷ The state immediately filed a motion requesting a change of judge and for the previous ruling awarding no damages to be vacated, which the Indiana Supreme Court granted in July.⁹⁸

In May 2015, the Hoosier Lottery Commission approved an amendment to Indiana's contract with private lottery manager GTECH Indiana to lower the amount of net lottery revenue it will promise to the state in exchange for lowering its management fee, changing the incentive payment structure, and providing the state an upfront payment of \$18.25 million. The company has missed its revenue targets twice since taking over lottery operations in 2012, in large part due to a slowdown in Powerball sales that is affecting lotteries nationwide. Rather than cancel the contract, commissioners felt that amendment was a better option, and they remain pleased with the vendor's performance overall, relative to other states.⁹⁹

Iowa

After a February 2016 approval from the federal Centers for Medicare and Medicaid Services (CMS), Iowa shifted the provision of health care services for 560,000 Medicaid recipients from state operation over to a Medicaid managed care system relying on three private insurers this April.¹⁰⁰ The privatization effort was originally slated to take effect in January 2016, but was delayed by CMS in December over concerns that the state was not ready to roll out full implementation.¹⁰¹ Citing the 39 other states and District of Columbia that have implemented private managed care models for Medicaid, Gov. Terry Branstad noted in a press release that "Iowa is ready for a new system that provides access through more doctors and will create a more sustainable Medicaid program for taxpayers."

Kansas

In May, Kansas Governor Sam Brownback signed Senate Bill 449, outlining comprehensive standards and licensure requirements for the care offered by facilities and providers of mental health and disability services.¹⁰² The legislation includes language granting broad authority to the state's Department for Aging and Disability Services to contract out services and facilities, with the condition that the state cannot privatize the operations or facilities of the Larned or Osawatomie State Hospitals without prior legislative approval.

In May, the state announced that it will negotiate new contracts for KanCare, the entity that provides health insurance for low-income Medicaid recipients and disabled Kansans, which was privatized in 2013.¹⁰³ Sunflower, UnitedHealthcare, and Amerigroup, which combined to lose \$52 million in Kansas in 2014, currently provide insurance to those individuals; whether more insurers will be added or one of the current providers will drop out remains to be determined.¹⁰⁴ Adding to the difficulty are budget woes for the state in

general— Governor Brownback introduced 4% cuts to Medicaid providers that went into effect this July.¹⁰⁵ After negotiations are completed, the new contracts are scheduled to begin in 2018.

Kentucky

This April, Gov. Matt Bevin signed House Bill 309, legislation authorizing the use of PPPs to finance, build and operate public infrastructure projects across state, city and county governments. The bill includes provisions requiring the secretary of finance to create a PPP regulatory framework, legislative approval for any PPP exceeding \$25 million, and the establishment of a PPP Oversight Committee.¹⁰⁶ Among its more specific terms is language explicitly prohibiting any tolls being charged on Interstates that cross into Ohio.¹⁰⁷

Though the act allows for a broad array of projects across agencies and levels of government, the conditions at many of Kentucky's state-owned parks were a factor in the passage of the PPP legislation, including lodging facilities at the state's General Burnside Island Park, which it has tried unsuccessfully to privatize since 2014.¹⁰⁸

Also in Kentucky, in September 2015, a consortium led by Macquarie Capital reached financial close on a deal with the state to design, build and operate a state-wide broadband network. The consortium also includes design-and-build contractors Black & Veatch, Ledocor, and Fujitsu.¹⁰⁹

The 30-year PPP, dubbed the Next Generation Kentucky Information Highway Project, or “Kentucky Wired,” will include a \$290 million bond issue—\$232 million in tax-exempt bonds, and \$58 million in taxable bonds, of which Allianz Capital agreed to purchase \$38.5 million in a forward purchase agreement.¹¹⁰ Under the deal, Macquarie Capital and its partners will design, develop and operate a 3,000-mile fiber network over the next 30 years, taking on the developmental and operational risks of the project, while the state will retain ownership of the network. Private sector broadband providers and others would then be able to tap into the main fiber network to deliver services into communities and ultimately the “last mile”—lines that run to individual homes or businesses.

After financial close was reached, in last November, AT&T challenged an attempt by the state to re-bid its contract to provide broadband internet to the state's public schools in an RFP, leading Kentucky to withdraw the RFP the next month.¹¹¹ The state was looking to end its relationship with AT&T so that public school broadband could be handled in-house via the Kentucky Wired broadband project, with the state searching for ways to fill the \$11 million revenue void that would result from AT&T's departure.¹¹²

Louisiana

New Gov. John Bel Edwards looked to renegotiate the state's hospital contracts upon entering office early this year. As reported in last year's *Annual Privatization Report*, previous Gov. Bobby Jindal worked to have nine of Louisiana's state-run hospitals privatized over 2013 to 2014, ultimately receiving final approval from the U.S. Centers of Medicare and Medicaid Services in December 2014.

Gov. Edwards cited the original hospital agreements as “hasty” and sought renegotiation as a means to improve efficiency and maintenance in contracts.¹¹³ While there is strong agreement that the level and quality of care provided has improved under the private arrangement, Gov. Edwards sought to achieve even greater savings while maintaining that level of quality.

Budget battles in the state legislature led to a funding level lower than what the governor wished, while administrators threatened to terminate the contracts as a result of the reduced funding. An amendment diverting \$72 million from college scholarship programs to the hospitals allowed Gov. Edwards’ desired funding levels to be achieved, and in late October, the renegotiated contracts were completed.¹¹⁴ The new deals included an additional funding increase of \$135 million for the hospitals (with a small portion going to state medical schools), partially achieved through increased funding for Medicaid.¹¹⁵

In other Louisiana privatization news:

- New Gov. John Bel Edwards signed legislation in 2016 requiring all state service contracts in excess of \$40,000 to receive Joint Legislative Committee on the Budget approval, after passing unanimously in both legislative chambers.¹¹⁶ The legislation, House Bill 454—signed into law as Act No. 408—mirrors legislation vetoed by then-Governor Bobby Jindal in 2014, as reported in the previous *Annual Privatization Report*.
- In May, the House passed legislation (House Bill 74) requiring a 15% cut in all consulting contracts, but failed to receive a vote in the Senate.¹¹⁷ A similar measure failed a House vote earlier this year in the First Extraordinary Legislation Session (House Bill 96).
- In June 2016, the state issued a final update to its cost savings estimates from its five-year Risk Management privatization contract with F. A. Richard & Associates (FARA). The state identified \$9.8 million in net savings from the contract, including \$11.9 million in administrative cost savings and \$44 million in litigation savings.¹¹⁸ Since the \$44 million figure falls short of the \$50 million in litigation savings guaranteed in the contract, FARA is required to pay up to 3% of the shortfall—approximately \$180,000.¹¹⁹ Reason Foundation’s *Annual Privatization Report 2015* covered the state’s previous cost savings report, which estimated \$16 million in net savings over the contract’s first three years, but contract costs and flawed figures for property insurance inflation contributed to the more modest net gains over the contract’s life.¹²⁰
- The state opened up bidding for a new contract for claims processing and loss prevention in late 2014, choosing Sedgwick Claims Management Service to replace FARA in March 2015, in a five-year contract for \$80 million that began in July of last year, the *Associated Press* reported.¹²¹ FARA tried unsuccessfully to challenge the decision in June, claiming then-Gov. Jindal’s bias toward Sedgwick, which led to a six-month emergency contract to Sedgwick while the dispute was resolved.¹²²
- In February, Northlake Behavior Health bought the state’s 40-acre Mandeville Psychiatric facilities site for \$6.7 million from St. Tammany Parish, which had bought the property from the state in 2014.¹²³ The company had been managing and operating the hospital on the site since 2013 in a lease

agreement with the state, which owned the property at the time. After buying the complete 294-acre hospital tract, St. Tammany sought bids in March 2015 to buy the 40-acre parcel where the 60-year-old hospital is located, leading the purchase deal with Northlake.¹²⁴

Maine

This February, Gov. Paul LePage sought to move forward with privatizing ASPIRE, Maine's welfare-to-work program, citing the threat of fines to the state for the program not meeting federal guidelines.¹²⁵ In January, the state's Department of Health and Human Services was facing \$29 million in fines for not meeting guidelines for its ASPIRE and Temporary Assistance for Needy Families programs, leading the state to seek outside help to improve outcomes.¹²⁶

In a first-time move for the state, the Department of Transportation chose a private firm to operate a bridge last December. Florida Drawbridge Inc. (FDI) received a five-year, \$3.8 million contract to operate Portland's Casco Bay Bridge, beating one other bidder, Maine-based Ciambro, which helped build the bridge, but whose \$7 million bid almost doubled FDI's.¹²⁷ The idea was first pushed by LePage last October, when the state first sought bids for the project.¹²⁸ FDI took over bridge operations in February in a training period, and began operating under a normal schedule in March.¹²⁹

Massachusetts

With the suspension of the state's Pacheco Law, the Massachusetts Bay Transportation Authority (MBTA) took steps toward privatizing much of its operations in July 2016. The transit authority issued an RFP in late June for a private firm to take over the operations of its warehouse, a move to which warehouse workers responded by immediately seeking arbitration, the *Boston Globe* reported.¹³⁰

MBTA also looks to privatize police and emergency dispatch, as well as its cash operations. For dispatch services, MBTA looks to contract with IXP Corporation for police and emergency dispatch.¹³¹ The two-year, \$6.1 million deal for police dispatch would free 15 officers from dispatch duties and allow them to work patrol, a major relief to MBTA Transit Police Superintendent Richard Sullivan, who said of the move, "This is going to help us tremendously."¹³²

The transit agency may also privatize its cash-counting operations after a consultant report found many problems with its current in-house arrangement, including poor training and recordkeeping, security lapses (including vault doors secured with duct tape), and employee shirking, as well as outdated and inefficient technology and equipment.¹³³ Officials believe that privatization could generate \$4.6 million in savings.

The 78 workers that the agency currently employs for its in-house cash counting make a combined \$10.1 million, or a little more than \$128,000 per worker, despite only completing a small fraction of the work that half as many cash-counting workers employed by private sector firms complete, the report noted.¹³⁴ MBTA

issued RFPs for its cash operations, and another for fare collection services and systems, for which responses were due in September.¹³⁵

Also in Massachusetts, auditors approved Gov. Charlie Baker's proposal to privatize emergency and mental health services in the southeastern part of the state this March.¹³⁶ The Baker administration estimates the proposal would yield cost savings of \$6.5 million and create consistency with the emergency mental health contracts used already throughout the rest of the state.¹³⁷

Michigan

In March, state lawmakers introduced 10 bills, collectively known as “the Sunshine Package,” which are designed to increase transparency by opening records from the legislative and governor's office to Freedom of Information Act requests, while also establishing an Open Records law, the website of the state's House Republicans reported in March.¹³⁸ The bills would allow for greater access to information relating to contracting with private firms, potentially including proprietary information. Agencies would be required to conduct cost/benefit analysis beyond comparing in-house vs. outsourcing, including effects on state coffers from laid-off employees receiving unemployment compensation.¹³⁹ As of press time, none of the bills—House Bills 5469-5478—had received a vote in the House.¹⁴⁰

An audit in February found major problems with the way the Grand Rapids Home for Veterans is operated by J25, citing high turnover, records falsification, understaffing, high absenteeism, neglect and abuse of patients, and inadequate training of staff.¹⁴¹ As mentioned in Reason Foundation's *Annual Privatization Report 2015*, the privatization of the facilities went through in 2013 after surviving a citizen-led legal challenge that lasted several years.

At the end of June, the state confirmed eight companies bidding on a new contract to take over the management of the Veterans' Home (including J25), with many expecting that multiple firms will end up handling the duties.¹⁴² A final decision is expected in the coming months.

In October 2015, the state's Department of Transportation (MDOT) entered into a 15-year, \$123 million PPP with BlackRock Infrastructure and Freeway Lighting Partners to finance, install and operate nearly 15,000 new lighting fixtures on highways in the Detroit metro area. Approximately 30% of current fixtures were not operational as of October 2015.¹⁴³ The partners began the process of replacing the lighting in April 2016, according to MDOT.¹⁴⁴

New Jersey

The state's PPP for New Jersey Lottery marketing and sales functions continued to face headwinds in its second full year of implementation. As discussed in previous editions of this report, in June 2013 New Jersey entered into a 15-year contract with Northstar New Jersey Lottery Group—a consortium that includes GTECH, Scientific Games and the Ontario Municipal Employees Retirement System—to take over the state

lottery’s marketing and sales functions, in exchange for a \$120 million upfront payment to the state and a contractual commitment to generate over \$1.4 billion in additional net income for the state over the life of the contract, relative to in-house operation. Other key operational functions—including security, oversight, licensing, auditing and prize payments—remain the responsibility of the state.

In FY2014, the first year of implementation, the PPP delivered \$965 million in net revenue to the state, which fell \$55 million short of revenue targets, triggering a shortfall payment to the state from Northstar of \$14.1 million. A similar pattern continued in FY2015 where, despite record gross revenues totaling over \$3 billion, the PPP delivered \$960 million in net revenue to the state, falling short of the \$1.05 billion target; the shortfall triggered another payment to the state from Northstar of \$13 million.¹⁴⁵

Nonetheless, some lawmakers and Treasury officials credited Northstar for producing better revenues than were likely to have prevailed in its absence, noting the challenging combination of the lingering economic effects of Hurricane Sandy and declining sales for some major gaming products. For example, Powerball particularly has done poorly in New Jersey as of late, with sales falling 29% in 2015 from already low 2014 numbers.¹⁴⁶

“I don’t mean to suggest for a moment that either the lottery or its partner, Northstar, believe flat revenues are where we want to be,” New Jersey Lottery Executive Director Carole Hedinger told the Senate Legislative Oversight Committee in November 2015.¹⁴⁷ “But achieving flat revenues, in the face of incredibly challenging national trends that no one foresaw when our agreement with Northstar was executed, is an accomplishment nonetheless.”

Nevada

In June 2015, Gov. Brian Sandoval signed a bill that includes provisions enabling the state to consider privatization of Medicaid services for the elderly and disabled in a managed-care model.¹⁴⁸ The state currently maintains contracts with two managed care organizations to provide some Medicaid services, but not for the elderly or disabled populations.¹⁴⁹ The next steps in the process include a fiscal assessment by the state’s Department of Health and Human Services, followed by a review of the request by the federal Centers for Medicare and Medicaid Services.¹⁵⁰

New York

In June 2016, the Port Authority of New York and New Jersey reached financial close on a \$4 billion PPP to rebuild LaGuardia Airport’s Terminal B, which will involve a 34-year concession with LaGuardia Gateway Partners, a consortium of Vantage Airport Group of Canada (a subsidiary of the Vancouver Airport Authority), Swedish construction company Skanska, and Paris-based asset manager Meridiam.¹⁵¹

The project will include a new 35-gate Terminal B, Central Hall, West Garage, related roadways and supporting infrastructure, according to a press release. The airport will remain fully operational while the

terminal is completely rebuilt, which is expected by 2022. After completion, the consortium will continue to handle operations and management of the terminal until 2050. The project will be financed two-thirds by private funds.

“[The] contractual closing of the public-private partnership and the imminent commencement of construction represent a huge step forward in Governor Cuomo and the Port Authority’s vision to modernize LaGuardia Airport,” said Port Authority Executive Director Pat Foye in a press release.¹⁵² “The new Terminal B will be a 21st Century facility offering a high level of customer service and amenities.”¹⁵³

In other New York State news:

- In May 2016, Governor Andrew Cuomo appointed a task force to study privatizing the State Fairgrounds in Onondaga County as a part of a \$50 million initiative to alter and repurpose the facility, the *Auburn Citizen* reported.¹⁵⁴ Improvements are expected to include a new Expo center, Equestrian center, the fair’s free concert stage, and an expansion of the RV park, the last of which is expected to be completed by late August.¹⁵⁵ A comprehensive report from the Task Force is expected by the end of the year. A previous attempt to privatize was rejected, but the Cuomo administration believes that the \$50 million initiative to improve the facility may make privatization more attractive to potential private partners.
- Governor Andrew Cuomo refused to sign a measure passed in both the state’s Senate and Assembly in June 2016 to move control of the state’s horse racing association (NYRA) back into private hands, *CBS 6 Albany* reported.¹⁵⁶ Instead, the state will continue to run the NYRA, with some changes to the makeup and appointment of the association’s board of directors.¹⁵⁷
- In April 2015, the state entered into an agreement with Xerox corporation to update the state’s technology for managing its Medicaid rolls. The five-year, \$564.9 million deal has the company updating software and equipment to create an advanced technological platform capable of managing all aspects of Medicaid patient management, the company noted in a press release.¹⁵⁸

North Carolina

In January, the North Carolina Legislature’s Program Evaluation Division issued a report that examined 133 state contracts valued at over \$1.2 billion and identified several shortcomings, including a general lack of accountability mechanisms to ensure cost efficiency, and widespread lack of compliance with state policies limiting the length of contracts.¹⁵⁹ The report recommends the modernization of the state’s contract management system, the preparation of business case analyses to explain the rationale for contracting, and the development of an inventory of services eligible for privatization. The state hopes to achieve the balance of ensuring greater oversight of private contracts while not discouraging would-be contractors from applying for projects.¹⁶⁰

In June, the state revealed its completed Medicaid proposal, which includes the privatization of most of its services.¹⁶¹ In July 2014, the North Carolina Senate approved legislation to create a new agency to administer

the state Medicaid program and a new program allowing for-profit managed care companies to compete with state-subsidized hospital plans for contracts to serve Medicaid beneficiaries.¹⁶² The legislation was more aggressive than a Medicaid proposal backed by Gov. Pat McCrory and the House that would have made more-limited use of managed care within the framework of accountable care organizations run by doctors and hospitals, and the parties failed to reach an agreement.¹⁶³

After the setback in the previous year, Gov. Pat McCrory signed legislation in September 2015 that authorizes the state to enter into contracts with three companies to provide insurance plans for Medicaid recipients statewide, and up to 10 other regional networks of doctors and hospitals.¹⁶⁴ Instead of the more traditional practice of paying for each service a Medicaid patient receives, the new plan will have providers receive a per-patient fee up front, while being responsible for cost overruns.

Ohio

In September 2015, the state issued an RFP for a consultant to conduct a detailed review of the Ohio Lottery, with a focus on efficiency and maximizing revenue.¹⁶⁵ The state awarded the contract to Spectrum Gaming Group, which concluded this September that the state should develop a comprehensive gaming policy that allows collaboration among the lottery, casinos and racinos, while also recommending that the lottery be converted to a quasi-public corporation. The report calls for the governor and the state legislature to grant more authority to the lottery, if the other recommendations prove politically impossible.¹⁶⁶

Responding to critics, representatives for the lottery stressed that privatization is not planned. “Not only is there no intent to privatize the lottery, but there is nothing in current law that permits us to take that path,” Ohio State Lottery Representative Danielle Frizzi Babb said in a statement. “The goal of the RFP is to undertake a business assessment that focuses on how to enhance and make lottery operations more efficient.”¹⁶⁷

Oklahoma

In May 2015, Gov. Mary Fallin signed House Bill 1566, which directs the Oklahoma Health Care Authority (OHCA) to issue a request for proposals for a contractor to create and implement a care coordination model for the aged, blind, and disabled (ABD) Medicaid recipients who are covered under the state’s SoonerCare program.¹⁶⁸ According to OHCA’s 2014 Annual Report, ABD patients accounted for nearly half of all SoonerCare expenditures, despite representing only 16% of state Medicaid enrollment.¹⁶⁹

Over the next few months, the state and its consulting firm, Pacific Health Policy Group, met with patients, families, and other stakeholders throughout the state seeking input to help choose the best managed care model. A request for information resulted in responses from 22 different entities interested in providing care for ABD patients, with OHCA ultimately choosing a fully capitated managed care model, where flat fees are paid per patient instead of as reimbursements for each specific service provided.¹⁷⁰

According to OHCA’s website dedicated to these changes, the state submitted a request for proposals in November 2016 which closes in January. A final decision is expected in May of 2017.¹⁷¹

Pennsylvania

In June 2016, the Commonwealth’s PPP board approved a project to have a company design, build, finance, operate and maintain a 550-mile fiberoptic cable that will run alongside the Pennsylvania Turnpike and roads in nearby areas, the state Department of Transportation announced in a press release.¹⁷² The project is estimated to be valued at around \$200 million, and a request for proposals is scheduled for February, 2017.¹⁷³ The cable, which is tentatively scheduled to be operational by 2018, will be used to better transfer toll data and communications between agencies, while also looking to facilitate the use of smart cars and other emerging transportation and communications technologies.

Separately, in March, PennDOT awarded a 20-year, \$84.5 million contract to Utah-based Trillium CNG to design, build, operate and maintain 29 compressed natural gas (CNG) fueling stations at public transit facilities around the state.¹⁷⁴ In addition to providing clean fuel for public transit vehicles, the CNG stations would also be open to the general public. “Natural gas is a valuable resource that provides affordable, cleaner options for vehicles in Pennsylvania,” PennDOT Secretary Barry Schoch said in a press release.¹⁷⁵ “This project will ensure we can capitalize on this resource and also benefit the authorities that provide vital transportation services.” In February 2015, the agency issued an RFP for the project after shortlisting four teams the previous month, of which Trillium submitted the winning bid.¹⁷⁶

In other Pennsylvania privatization news:

- State Representative Eli Evankovich introduced legislation, House Bill 2213 that would create a pilot program for social infrastructure PPPs—allowing up to 12 of them—while also establishing a state PPP oversight board. Potential asset classes included telecommunications, water, stormwater and wastewater systems, schools and utilities with a minimum value of \$25 million.¹⁷⁷ In June, the bill was referred to the Finance Committee, but ultimately did not receive a vote during the 2016 legislative session.¹⁷⁸
- Last September, the Commonwealth started the bidding process for private companies to take over its Medicaid operation, Community HealthChoices, valued at \$17 billion.¹⁷⁹ This April, the state finalized three-year agreements with eight different managed care organizations to operate HealthChoices.¹⁸⁰ The contracts put a strong emphasis on the partners establishing more value-based and outcome-based agreements with hospitals and providers, setting targets for at least 30% of Department of Human Services funding to go toward such services by the end of the agreements.¹⁸¹ The plan divides the state into five different regions, with four to five providers serving each region. UnitedHealthcare of Pennsylvania, Vista, and UPMC for You will provide care in all five regions, with Centene and Gateway providing care in multiple regions. Additionally, Geisinger and Health Partners plans will offer plans to the Northeast and Southeast regions, respectively.¹⁸²

Tennessee

In March 2016, the Tennessee Department of Finance and Administration released a business case analysis of the potential cost savings from privatizing facility management services for state facilities still managed in-house, including higher education facilities. The report estimates a first-year cost savings of \$29.7 million under privatization, ramping up to an annualized cost savings of \$35.8 million in the following years.¹⁸³ The state released a request for qualifications the following month and plans on releasing the responses early next year.¹⁸⁴ A total of 10% of the state's real estate portfolio has been privately managed since 2013, which administration officials estimate has saved taxpayers \$13 million over the first two years of its existing contract with Jones Lang LaSalle.¹⁸⁵

In February, the Tennessee Department of General Services issued a request for information seeking PPP contracting advisory services to help determine the feasibility of using PPPs to deliver major state building projects. "We're not inventing something new here," DGS Deputy Commissioner John Hull recently told the *Nashville Business Journal*.¹⁸⁶ "We would be following the lead of other states that finance projects like this. [A company] would bring forth its financing resources so the state wouldn't have to shoulder all of the burden." Responses were due in early March, but as of press time, there were no further developments.

In other news, the state received no responses from bidders in an attempt to privatize hospitality and management services at the state's parks and recreational facilities late last year.¹⁸⁷ Gov. Bill Haslam's administration issued a request for information in February 2014 seeking interest from potential private sector partners to manage restaurants, inns, golf courses, and other recreational facilities,¹⁸⁸ but as the procurement process moved forward, uncertainty over the fate of \$55 million in upgrades requested by Tennessee Department of Environment and Conservation caused at least one of three potential bidders to withdraw from consideration.¹⁸⁹

Texas

In June 2015, Gov. Greg Abbot signed House Bill 2475, which authorized the creation of a new state PPP advisory body—the Center of Alternative Finance and Procurement—largely modeled after PPP Canada.¹⁹⁰ This January, the new center began serving the state, assisting agencies in the areas of negotiations, planning, financing, and procurement.

Gov. Abbot also signed Senate Bill 20 in 2015, which aims to improve transparency and accountability in its contracting process.¹⁹¹ Among its provisions, the bill would require public disclosure of all no-bid contracts (and a public justification for using them), require agency employees involved in contracting to disclose any possible conflicts of interest, prohibit contracts with firms in which agency leaders or staff have a financial interest, and require the agency's board chair or director to sign any contract valued over \$1 million.

The legislation comes in the wake of a January 2015 report from the Texas State Auditor's Office reviewing 14 contract audits conducted since 2012 that found that, while state agencies generally complied with

contract planning and contract formation requirements, they “did not consistently comply with contract procurement and contract monitoring requirements.”¹⁹²

Utah

In April 2015, the state’s Free Market Protection and Privatization Board (FMPPB) issued a template for a state privatization review process entitled the “Process for Evaluation for Alternative Service Delivery Strategies.”¹⁹³ The 60-page document is intended to provide a consistent framework for identifying, evaluating, and implementing potential privatization projects, as well as information about monitoring different privatization and contracting measures in the post implementation period.

In the FMPPB’s 2015 Report on the Utah State Office of Education (USOE), the board concluded that the development, marketing, and operation of Aspire, the USOE’s student information system (SIS), suffered from problems relating to unfair competition. Some of the board’s recommendations to address those concerns include a legislative review of the state’s vendor selection process, USOE promotion of all statewide SIS options used by local providers (as opposed to the in-house Aspire SIS only), and that the state should take a thorough look at fully privatizing Aspire.¹⁹⁴ In its 2015 annual report, the FMPPB noted that the state’s Executive Appropriations Committee took no action on those recommendations, despite receiving backing action from the Public Education Appropriations Subcommittee.

The 2015 FMPPB Annual Report also noted the expansion of a pilot program with Enterprise Car Rental to provide fleet vehicles, based on good performance of the initial program. At press time, the state was also evaluating responses to a request for proposals for managing the purchase, acquisition and maintenance of its vehicle fleet.¹⁹⁵

Virginia

The state’s Joint Legislative Audit and Review Commission released a report in June 2016 that found significant problems with the state’s contracting practices.¹⁹⁶ The study looked at 117 high-value contracts, through surveys sent to administrators in 23 agencies, and found cost overruns to be the most common problem in meeting performance standards. This occurred in almost half of the contracts studied (49%).¹⁹⁷ The agency also identified other issues in the contract negotiations process, finding that administrators often do not seek any counsel from the Attorney General’s Office during negotiations, often leading to terms that are very risky for the state. The study was released nearly a year after the state incurred a \$250 million cost related to a cancelled toll road project.¹⁹⁸

As a 13-year contract with Northrup Grumman for the Commonwealth’s information technology services gets closer to expiration (2019), the Virginia Information Technology Agency (VITA) is exploring different contract models outside of the single contractor agreement that the state entered into back in 2006. A report by Integris Applied given to VITA in November 2015 made four key recommendations: the state should

work to get out of the old contract now, adopt a multi-supplier IT contractor model, create a new office to manage service delivery, and adopt an approach that allows more agency involvement and input.¹⁹⁹

While officials noted the company does maintain good reliability figures overall, large outages and other network problems have occurred occasionally, including one that shut down all of the state's DMV offices for a day; another in January affected all executive offices and the General Assembly.²⁰⁰

In May 2016, the state accused Northrop of breach of contract over failing to archive emails while involved in a federal lawsuit filed in 2013, after Northrop assured state officials that all of the needed correspondence would be retrievable. A letter dated from this January from VITA to Northrop outlined 10 “operational issues” which the company should correct.²⁰¹

Washington State

In the 2014 legislative session, the Washington Federation of State Employees—an affiliate of the national American Federation of State, County and Municipal Employees union—initiated the so-called “Taxpayer Protection Act” (House Bill 2743), introduced by State Rep. Sam Hunt, that would have placed a number of procedural hurdles in front of privatization initiatives undertaken by the state Department of Enterprise Services (DES). The bill ultimately passed the House before being tabled by the Senate, but a nearly identical bill—House Bill 1915—was introduced in 2016 in a substitute bill (a similar bill also failed to pass in 2015).²⁰²

The legislation would amend the 2011 law requiring the state's Office of Financial Management to identify six central service functions performed by the state to potentially contract out every two years. The most significant change the law would make would be to only allow DES to contract out if it would achieve cost savings, and in calculating those cost savings DES would be required to factor in the cost of the agency staff time and resources needed to monitor the contract and ensure compliance with performance standards in the contract.

The 2014 version of the bill would have required mandatory cost savings of 10% or more of the contract value before DES would be allowed to contract out a service; the subsequent versions stripped out the 10% savings requirement, simply requiring cost savings of an unspecified amount.

Further, prior to issuing a request for proposals to outsource an existing activity performed by public employees, HB 1915 would require state agencies to conduct a comprehensive impact assessment that includes: (1) an estimate of the in-house costs of public employee service provision, (2) an estimate of the costs associated with contracting out, (3) a statement of the performance objectives to be achieved through outsourcing, and (4) an assessment of the potential adverse impacts of outsourcing, such as loss of employment, effect on social services and public assistance programs, economic impacts on local businesses and local tax revenues, and environmental impacts.

If a contract is ultimately signed, the bill would require state agencies to include this impact assessment in a report submitted to DES, along with an itemization of performance standards contained in the contract. Every five years thereafter (or upon contract completion) the bill would require DES to prepare a report including documentation of the contractor's compliance with the itemized performance standards, itemization of any contract extensions or change orders that resulted in a change in contract costs, and a report of any remedial actions taken to enforce compliance with the contract and associated public sector costs.

Other bill provisions would require state contracts to include a set of standard terms (including cancellation clauses and employment and wage disclosures for all contractor and subcontractor employees) and set forth criteria the Joint Legislative Audit and Review Committee must consider in its audit of the DES contracting program.

The bill ultimately received no Senate vote in the 2016 legislative session, after passing the house 52–43 in February.²⁰³

West Virginia

The West Virginia Department of Health and Human Resources (DHHR) issued a press release in December 2015 estimating more than \$50 million in savings in the previous fiscal year resulting from expanding the population served in Medicaid managed care, adding several services to managed care, and decreasing the capitation rate for the traditional managed care populations. “By privatizing the delivery of Medicaid services and strengthening oversight of managed care entities, we are experiencing greater efficiency and accountability than the traditional Medicaid model,” said Jeremiah Samples, DHHR deputy secretary for public health and insurance.²⁰⁴

Also, the West Virginia Legislature considered a bill in the 2016 session that would set the stage for the potential sale of three state-operated nursing homes. House Bill 4352 would have required the state Department of Health and Human Resources to prepare and submit a plan for the potential sale of the Hopemont Hospital, Jackie Withrow Hospital, and John Manchin Sr. Health Center and Lakin Hospital by the end of November 2016. In February, the bill passed the House in a 53–46 vote after being approved by both the House Health and Human Resources and Finance Committees, but was rejected by the Senate in March.²⁰⁵

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