
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: 150

City of San Diego Proposed Small Local Business Enterprise Program

OVERVIEW

On Monday, January 11, 2010 the City Council is being asked to approve necessary actions to establish a Small Local Business Enterprise Program (SLBE) that would apply to Public Works, Consultant, and Goods & Services contracts. If approved, the SLBE will offer the City an additional option to help ensure that all segments of the local business community have a reasonable and significant opportunity to participate in City Contracts. The SLBE program will be in addition to the City's existing Subcontractor Outreach Program and will be administered primarily by the City's Equal Opportunity Contracting Program (EOCP) but will also involve other City departments including Purchasing and Contracting and Engineering and Capital Projects.

Even with an increased focus on equal opportunity contracting by the City over the past few years, the participation of underutilized Disadvantaged Business Enterprises (DBEs) on public works projects has historically been abysmal. At the September 2, 2009 Rules, Open Government, and Intergovernmental Relations Committee (Rules Committee), the EOCP presented their semi-annual report on construction, consultants, and vendor participation statistics. The statistics presented at the September Rules Committee reflected a continued trend of minimal participation of DBEs. After hearing EOCP's Semi-Annual update, the Rules Committee members directed the Equal Opportunity Contracting Program staff to:

“...return to the committee on October 28, 2009 with a policy regarding a proposed Small Local Business Program as well as any other policies that may help increase the contracting disparities reflected within the EOC semi-annual update.”

At the October 28, 2009 Rules Committee meeting the committee members unanimously approved moving the staff's recommendation to forward the proposed SLBE program to the full City Council for consideration with the following additions as suggested by the IBA:

1. Include language in the draft proposal that requires the SLBE program goals to be reported to the City Council annually and, if they change, an explanation of why;
2. Add examples to the draft proposal to clarify what is expected of the mentors; and
3. Add language to include audit and reporting requirement of the SLBE program.

The changes suggested by our office have been incorporated into the proposed SLBE program that is before the City Council for consideration. In addition, the Rules Committee directed the Administration Department to complete an availability study and send the necessary data to the Equal Opportunity Commission to create a running list of available small businesses and contractors. Staff has stated that they have provided the chair of the Equal Opportunity Commission with the running list of available small businesses and contractors.

The following section discusses possible fiscal impacts to the City by implementing the SLBE program. In addition, our office has identified items that the City Council may want to consider as they discuss the proposed SLBE program.

FISCAL/POLICY DISCUSSION

The SLBE program implements a bid discount and/or the awarding of "preference points" to eligible Small and Emerging Local Business Enterprises (SLBEs/ELBEs) for the contracting out of Public Works Projects, Consultant Projects, and Goods & Services Contracts.

Fiscal Impact of 5% Bid Discount for SLBEs/ELBEs for Public Works Contracts Valued over \$500,000 and under \$1,000,000

The SLBE program includes a 5% bid discount for SLBEs/ELBEs for Public Works Contracts valued over \$500,000 and under \$1,000,000. The 5% bid discount is consistent with a similar program that is in use by the State of California. In addition, the 5% bid discount has been reviewed by stakeholders; and City staff has stated that they support the proposed percentage discount. The following example, which was provided by staff at the October 28, 2009 Rules Committee meeting, illustrates how the 5% bid process would be administered:

Bidder A, a non-SLBE submits a bid of \$700,000 for a Public Works Contract. Bidder B, a SLBE submits a bid of \$730,000 for the same project. Under the SLBE program proposal, a 5% discount will be applied to the **Lowest Responsible Bid** submitted and then used to discount the SLBE's bid. Under this example, staff would use Bidder A's bid as the Lowest Responsible Bid to calculate the

discount (5% X \$700,000 = \$35,000). Bidder B's original bid of \$730,000 is then reduced by \$35,000 resulting in a total bid proposal of \$695,000. When compared to Bidder A's proposal of \$700,000, Bidder B's bid at \$695,000 would be awarded the contract. In the event of a tie, the SLBE would be awarded the contract.

It is important to note that the 5% bid discount is used only to competitively compare bids and the City will still pay the non-discounted bid amount. Using the above example, the City would pay the non-discounted bid of \$730,000 submitted by Bidder B for the contract resulting in an increased contract expense to the City of \$30,000 (the difference between Bidder A's \$700,000 bid which is the true low bid and Bidder B's \$730,000 bid). Under the proposed SLBE program the maximum a project can be discounted for comparison purposes is \$50,000.

Staff has estimated that if the 5% bid discount had been in place for Fiscal Year 2009, the estimated maximum impact to the City would have been \$562,974. This is based on the number of projects (14) that were valued in the \$500,000 to \$1,000,000 range and would have fallen under the SLBE program. However, the true cost to the City as a result of the 5% bid discount will be difficult to determine until the program is fully implemented. The additional cost to the City is contingent on the number of projects that are awarded to SLBEs/ELBEs and therefore, results in a higher contract cost than the actual lowest bid. The possibility exists that even when the 5% discount is applied to SLBEs/ELBEs they will not be the lowest bidder. When this occurs, the City will be awarding the contract at the actual lowest bid.

Another possible fiscal impact of implementing the SLBE program relates to the "sizing" of Public Works Projects to ensure that an adequate number of projects will fall into the SLBE program's project ranges. For smaller projects similar in nature, the Engineering & Capital Projects Department "bundles" projects under one RFP to ensure the lowest cost to the City by having one company complete the work. By sizing projects to fall into the SLBE dollar range, multiple RFPs may need to be processed. As a result, the savings from having one company complete the work might not be realized. However, staff estimates that the increased contract costs should be minimal.

Fiscal Impact of the 2% Bid Discount for Goods and Services Contracts

The current Council Policy for local vendor preference (Council Policy #100-10) states:

"The City shall purchase materials, supplies and services from businesses within the City of San Diego and that all or any purchase of the City Sales Tax returned to the City shall be considered in the evaluation of the bids."

The current sales tax rate for the State of California is 8.75% of which the City of San Diego receives 1.0%. To comply with Council Policy 100-10, the Purchasing and

Contracting Department has historically applied a 1% discount to local businesses bidding on Goods & Services Contracts. Under the proposed SLBE program, the bid discounts will be increased to 2% with a cap of \$10,000 for each contract and applied to Goods and Services Contracts of \$50,000 and above. Staff has stated that the 2% discount was selected due to the benefits to small and local businesses while having a minimal fiscal impact to the City. *The IBA suggests that the City Council may want to discuss in more detail the rationale for the 2% bid discount for Goods and Services Contracts and why another percentage rate was not used.*

It is important to note that the 2% bid discount for Goods and Services Contracts will be applied differently than the discount is applied to Public Works Contracts. With Public Works Contracts, the bid discount will be applied to the **Lowest Responsible Bidder** and then subtracted from the SLBEs/ELBEs bid. With Goods and Services Contract bids, the **2% discount will be subtracted directly from the SLBE's bid**. This is consistent with how the Purchasing and Contracting Department is administering the 1% discount for local vendors under Council Policy 100-10. However, reducing the 2% bid discount from the SLBE's bid, instead of basing the reduction on the Lowest Responsible Bidder's bid, will result in a larger discount for SLBEs/ELBEs bids. *It is unclear why the bid discounts are applied differently from Public Works Contracts and Goods and Services Contracts and the City Council may want to discuss the rationale with staff at the Council meeting.* Regardless of how the bid discount is applied, the City will pay the non-discounted bid cost.

Similar to the Public Works Projects bid discounts, the true fiscal impact to the City of granting a 2% discount for Goods and Services Contracts is difficult to determine until the program has been fully implemented. In Fiscal Year 2009, the City had 356 Goods and Services Contracts over \$50,000 with a total cost of \$206.4 million. If each of the contracts were discounted the maximum bid discount of \$10,000, the fiscal impact to the City would have been \$3.6 million. However, this is an extreme example and reflects the maximum impact to the City based on Fiscal Year 2009 expenditures for Goods and Services Contracts.

Impact on Staffing from the Implementation of the SLBE

The implementation of the SLBE program will require staff to assume additional responsibilities to ensure compliance with the program. One example is the certification of eligible participants for the SLBE program. This includes verifying that qualified businesses have no less than twenty-five percent of a firm's total number of employees domiciled in either the City of San Diego and/or San Diego County. For Public Works Contracts, Prime Contractors and consultants must submit a Final Summary Report that includes all subcontracting/subconsulting activity during the project within 15 calendar days after final inspection. EOCP staff then has ten business days to review and verify that 100% of the subcontract participation actually occurred.

Staff has indicated that they will be using existing personnel to facilitate the program. The majority of the increase to the workload will be related to the initial certification of businesses for the program. Once the initial certification process is complete, staff will be able to use existing operational processes to ensure continued compliance with the program.

Although staff has stated that they are confident that the current staffing level will be able to handle the implementation and ongoing oversight of the SLBE program, the IBA is concerned that this is an increase in workload and could impact the overall effectiveness of the EOCOP program. The impacts of the SLBE on the EOCOP will need to be closely monitored.

Audit Function

In response to the Rules Committee's October 28, 2009 direction, staff has included language requiring periodic audits of the SLBE program. The inclusion of an audit requirement for the program is crucial in determining if the program is cost effective. It will also enable the City Council to identify areas that are working effectively and others that need to be improved. These periodic audits should include the following criteria:

1. Verification of documentation reflecting bidders' good faith efforts.
2. Verification of the SLBE/ELBE certification process.
3. Verification of dollar payments to subcontractors and percentage subcontract participation as represented by bidders in Final Summary Report forms.
4. A review of EOCOP implementation and compliance with the Small Local Business Enterprise Program standards and procedures.
5. A cost-benefit analysis of the bid discounts, minor construction projects including an assessment of administrative costs to the City, bidder compliance costs, and an assessment of the level of subcontract participation with and without application of the program, and recommendation regarding program amendments, program continuation, or program termination.

The IBA would note that the specific criteria of the audit listed above was included in the 12/22/09 Proposed Small Local Business Enterprise Program Overview provided by the Administration Department. However, this criteria was not included in the draft Municipal Code or the revised Council Policy presented to the City Council that would implement the SLBE program. Both the Municipal Code and the revised Council Policy include general language that states that a periodic audit is required. ***The IBA recommends that the more specific audit language found in the Administration Department's 12/22/09 SLBE Program Overview be included in the proposed Municipal Code and the revised Council Policy.***

One other item concerning the Audit Function that the City Council may want to consider is that the audit language included in the Administration Department's 12/22/09 SLBE

Program Overview states that the City's Independent Auditor or some other independent body or auditing firm identified by EOCP shall conduct periodic audits. If the City's Auditor was to undertake the audit of the SLBE program then it would need to be added to his Annual Work Plan.

Implementation date of the Program

The implementation date of the SLBE Program is scheduled for July 1, 2010 as reflected in the City Attorney's Digest as indicated that it will take time to certify eligible businesses for the program.

CONCLUSION

The IBA supports the implementation of the SLBE program. While the SLBE program could have a fiscal impact to the City, the IBA notes that any increased costs will need to be weighed against the overall benefit associated with the increased participation in contracting opportunities afforded to local small and disadvantaged business enterprises. In this report the IBA has made the following recommendation for City Council consideration:

- ***The IBA recommends that the more specific audit language found in the Administration Department's 12/22/09 SLBE Program Overview be included in the Municipal Code and the revised Council Policy.***

[SIGNED]

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APPROVED: Andrea Tevlin
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