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Annual Privatization Report 2015

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

In 2014, states' fiscal health remained in a virtual holding pattern, as state economies continued to slowly recover from the impacts of the Great Recession. Overall, state revenues continued to increase for the fifth straight year off of their FY 2010 lows, and relatively few states had to contend with major budget deficits, in contrast to the years immediately following the onset of the recession. While the short-term trends have been relatively positive for states, and state budgets have continued their slow fiscal recovery since the end of the Great Recession, several reports released in 2014 have suggested that significant threats still loom.

First, the National Conference of State Legislatures (NCSL) released its *State Budget Update: Spring 2014* report in May 2014, offering a fiscal snapshot based on surveys of legislative budget officers.¹ According to the NCSL report, the state budget forecast is “stable,” with 34 states (plus the District of Columbia and Puerto Rico) reporting that they expect to meet their current fiscal year revenue forecasts, and another nine states report that they expect revenues to exceed forecasts. Only seven states (Delaware, Indiana, Kentucky, North Carolina, Oklahoma, Tennessee and West Virginia) reported revenues coming in lower than forecast.

Despite the positive news on the revenue front, expenditures have been more of a mixed bag. Twenty-two states—nearly half—reported spending in excess of budgeted amounts in fiscal year 2014, though NCSL notes the amount of overspending was “modest.” Major categories of overspending include corrections and public safety (11 states), K-12 education (8 states) and Medicaid (8 states).

Despite the relatively stable state fiscal situation, NCSL reports that state budget officials remain concerned about “sluggish revenue growth, rebuilding budget reserves and long-term spending trends—especially for K-12 education and health care.”² According to NCSL, some states are already projecting the emergence of structural budget deficits by fiscal year 2016, with more states expecting to join them beyond that.

Next, in May 2014 the Pew Charitable Trusts released an analysis of states' ongoing recovery from the economic impacts of the Great Recession, which found that despite an overall recovery in tax revenues collected by states, tax collections in 26 states had still not rebounded to their pre-recession peaks.³ In fact, five states—Alaska, Florida, Louisiana, New Mexico and Wyoming—are still seeing tax receipts down more than 15% relative to their previous pre-recession peak levels.

Further, even though aggregate states tax revenues were 2.2% higher than their 2008 inflation-adjusted peak by the end of the final quarter of 2013, Pew found that more than half of the states seeing record revenues had increased taxes since the start of the recession. Thus, the revenue gains in those states are likely to be at least partially attributable to policy changes, as opposed to economic growth.

Further, Pew notes that the 2.2% increase relative to the pre-recession peak is a modest level of growth that will do little to compensate for reduced federal transfers to states, increased state populations (up 10 million since the end of the recession), new Medicaid enrollees and state debt obligations.

“Even when tax revenues bounce back, policymakers will face challenges because of competing demands that piled up during the recession,” according to the Pew analysis.⁴ “Getting back to peak returns states only to where they were in purchasing power years earlier, leaving little money available to start making up for investments and spending they postponed during the downturn.”

Next, the National Association of State Budget Officers (NASBO) released its latest *State Expenditure Report* in November 2014, which found that total state expenditures grew a modest 2.2% in FY 2013, up from a 1.1% decline in FY 2012 that was the first such decline in the report’s 26-year history.⁵ The report estimated that total state spending in FY2014 increased by 5.7% due to an increase in both state and federal funds. Other findings from the NASBO report include:

- In FY2014, the main revenue sources funding total state spending were general funds (40.5%), federal funds (30.3%), other state funds (27.1%), and bonds (2.1%).
- In terms of total state expenditures (which includes federal funds), the top five spending categories in FY2014 were Medicaid (25.8%), K-12 education (19.5%), higher education (10.1%), transportation (7.7%) and corrections (3.1%).
- 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 (24.2%), Medicaid (15.3%), higher education (12.9%), transportation (6.8%), and corrections (4.5%).

Looking forward, the NASBO report suggests that while fiscal conditions continue to improve, “states remain concerned about both the short- and long-term outlook due to

increased spending demands, recent volatility in states revenues, and uncertainty surrounding future federal fiscal policies.”⁶

In December 2014, NASBO issued its latest *Fiscal Survey of the States*, which found that states are expected to see moderate fiscal improvement in 2015, continuing the trend of slow, but sustained, recovery in recent years in the wake of the Great Recession.⁷ Among its findings:

- After dipping for several years, state general fund spending surpassed pre-recession highs for the first time in fiscal year (FY) 2013 and is expected to end FY 2015 at a level 9.4% higher than the pre-recession peak (not adjusted for inflation).
- Forty-three states have enacted higher general fund spending levels in FY 2015, with aggregate general fund spending rising to \$751.6 billion, a \$22.7 billion (or 3.1%) increase over FY 2014 levels. This is a smaller increase than the 4.9% spending growth seen in FY 2014.
- Overall state spending levels are also expected to rise in FY 2015, but at a slower pace than the historical average.
- Education and health care are seeing significant spending increases this year. In FY 2015, 39 states increased general fund spending for K-12 education by \$11.1 billion, 36 states increased Medicaid spending by a net \$8.5 billion, and 40 states increased higher education spending by a net \$4.4 billion. Further, 35 states increased corrections spending, and 12 states enacted transportation spending increases.
- All areas of the budget are seeing aggregate spending increases in FY 2015 except public assistance, where 12 states have made general fund budget cuts yielding a net decrease of \$590 million.
- State general fund revenues are projected to increase in most states, rising by 3.1% to \$748.3 billion in FY 2015, an increase over the 1.3% gain the previous year.
- A total of seven states have made \$852 million in mid-year budget cuts thus far, a decline relative to the previous two years.
- A total of 21 states cut taxes in FY 2015 by an estimated \$2.3 billion, slightly higher than the \$2.1 billion in tax cuts enacted the previous fiscal year. Only 10 states increased taxes in FY 2015.
- Ending account balances and the amounts in budget stabilization (e.g., “rainy day”) funds are expected to fall a second straight year from their post-recession

high of \$70.6 billion in FY 2013, representing 10.5% of general fund expenditures that fiscal year. Balances will decrease in FY 2015 to \$53.1 billion (7.3% of general fund expenditures) down from their FY 2014 level of \$62.7 billion (8.9% of general fund expenditures). However, the two states with the largest reserves—Texas and Alaska—account for over 38% of total state balance levels in FY 2015, and balances in the remaining 48 states are only projected to average 4.8% of general fund expenditures.

Despite the slowly improving fiscal health, the report suggests that states will continue to face difficult spending decisions in areas like Medicaid and higher education, in which growing costs are outpacing inflation and state revenue growth. Overall, the NASBO report concludes that “states are in a better position than they were a few years ago”, but “with annual increases in revenue and spending still below historical averages, difficult decisions regarding budgetary tradeoffs are likely to remain for states.”⁸

Last, the Government Accountability Office (GAO) offered a more dire long-term outlook in its December 2014 edition of its *State and Local Governments’ Fiscal Outlook*, which found that both state and local governments will continue to face near-term and long-term fiscal challenges—with a growing gap between revenue and spending—through the year 2060, absent significant policy changes.⁹ 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.”¹⁰ GAO estimates that taking steps to close the looming fiscal gap today would require reducing overall state and local government expenditures by 18% and then holding spending essentially flat (as a percentage of GDP) for decades to come. The magnitude of needed expenditure reductions is up from 14.2%, as reported in the 2013 edition of the GAO *Outlook*.

Overall, these reports suggest that the recovery of state finances since the end of the Great Recession has been slow and steady overall (albeit uneven on an individual basis), but there is a significant risk of future fiscal challenges emerging that could pressure state budgets and set back their economic recovery. These trends are likely to prompt policymakers to continue seeking greater fiscal restraint and new ways to control costs and increase government efficiency.

B. Social Impact Bonds Update

The emergence of a new public-private partnership concept known as “social impact bonds”—or sometimes referred to as “pay for success” or “social finance” initiatives—in recent years has captured the attention of policymakers, investors and social service organizations alike. The term “social impact bond” is somewhat of a misnomer, as these programs are not typically derived from government-issued bonds. Rather, they are performance-based contracts in which private investors provide upfront capital to launch the programs, with costs recouped later via a government success payment only if pre-determined outcome targets are met. In short, a social impact bond (SIB) uses private sector funding to advance new public sector social service delivery models on a performance basis.

In a typical scenario, private philanthropic groups and other financiers fund social service interventions to be delivered by nonprofits and other nongovernmental organizations on behalf of governments under a pay-for-success contract model. If the privately financed interventions improve social outcomes and save public funds—essentially by getting better results than existing government social programs—investors would receive success payments from government that generate a return on investment. If outcomes do not improve, government doesn’t pay, placing the focus squarely on implementing evidence-based practices that deliver results, lest investors risk their investments.

SIBs were first pioneered in the United Kingdom, rapidly spreading to the United States and other countries. In August 2012, New York City became the first local government in the U.S. to pilot an SIB initiative in the area of youth recidivism, and several other states and local governments have announced or advanced SIB projects since then, as discussed in Reason Foundation’s *Annual Privatization Report 2014*.

Perhaps the most noteworthy development on SIBs in 2014 came in August with the release of an interim report on the first phase of the U.K.’s Peterborough Prison Social Impact Bond—the first SIB pilot program in operation, aimed at reducing recidivism among released short-sentence inmates—which found that the program delivered an 8.4% reduction in reconvictions among the first cohort of 1,000 prisoners in the program, relative to the national baseline.¹¹ Overall, the Peterborough pilot saw 142 reconvictions per 100 prisoners, compared to 155 reconvictions per 100 prisoners in the national control group.

While the results were not high enough for private investors to recoup their investment in the program early at this interim point—which would have been triggered at a 10% reduction in reconvictions for this first cohort—the project sponsors are confident that the program is on track to hit its final target of a 7.5% reduction across both program cohorts in the project by 2016, the threshold at which investors would generate a return on investment in the program.

While the Peterborough SIB program was originally slated to operate through 2016 and consist of three two-year cohorts of 1,000 offenders each, the U.K. Ministry of Justice announced in April 2014 that the program would be wound down early to make way for a nationwide payment-by-results program launching in 2015 as part of the Transforming Rehabilitation initiative. The Transforming Rehabilitation program will revamp the national probation system by opening up the market to 21 community rehabilitation organizations from the private, voluntary and social sectors that will be paid based on their results in reducing reoffending. The program will be funded by the government—not private investors, as in an SIB—and will extend rehabilitation to the roughly 45,000 short-sentence offenders annually released from prison who currently receive no supervision after release.

The early winding down of the Peterborough SIB—the first, and thus most closely observed, SIB program around the world—brought mixed reactions from experts following the development of social finance initiatives. Rick Cohen at *Nonprofit Quarterly* has questioned the SIB model’s reliance on private investment—and by extension, the premiums awarded to private financiers in successful projects—and wondered if the time spent developing such complex financial structures “might be better spent on public policy lobbying to create a more widely available program rather than designing the arcane structure of a SIB for the benefit of private investors tied to one project.”¹²

Meanwhile, analyst David Ainsworth at Civil Society Media noted that despite the complexity of SIBs and some ethical concerns about marketizing disadvantaged populations, the delivery model appears to have worked and the funding model attracts new sources of capital, incentivizes effective procurement, and transfers risk away from the nonprofit sector to “professional risk takers,” adding that “SIB’s holistic style of intervention works—long-term, connected to all stakeholders, focused on a broad outcome.”¹³

In other news, major highlights from 2014 and early 2015 in the area of social finance follow:

- **Federal:** In June 2014, Congressmen Todd Young (R-IN) and John Delaney (D-MD) introduced the bipartisan Social Impact Bond Act (H.R. 4885), which would have allocated \$300 million to a new program in which state and local governments would compete for funds to repay investors that partner with those jurisdictions to implement privately financed, evidence-based social service interventions aimed at addressing unemployment, welfare dependency, child abuse prevention and other social challenges. “This bipartisan legislation harnesses the power of the private sector to improve government services while saving taxpayer dollars,” Rep. Delaney said in a press release. “Best of all, it moves our government to be more evidence-focused, so we can pay for achieving desired outcomes rather than paying for services regardless of the outcome.” The House ultimately did not take action on the bill before the end of the 113th Congress, but the two sponsors plan to introduce similar legislation—the proposed Social Impact Partnerships Act—in early 2015.
- **Federal:** In July 2014, President Barack Obama signed into law the Workforce Innovation and Opportunity Act—an overhaul of the 1998 Workforce Investment Act—that includes provisions to facilitate the expanded use of pay-for-success contracting, including authorization for local workforce boards to reserve up to 10% of their federal funding for pay-for-performance initiatives, which would total approximately \$300 million in funding for such programs.¹⁴ The law passed with overwhelming bipartisan support.
- **Illinois:** In May 2014, former Illinois Gov. Pat Quinn announced the launch of the state’s first pay-for-success (PFS)/social impact bond contract, making it the third state—after New York and Massachusetts, which launched similar programs in late 2013/early 2014—to experiment with this emerging performance-based contract model. Illinois’s PFS project seeks to improve outcomes for at-risk youth by reducing their dependence on the state’s child welfare and criminal justice systems. The state plans to partner with One Hope United and the Conscience Community Network to improve placement outcomes and reduce re-arrests through providing evidence-based community alternatives to institutional care, and the PFS project will serve approximately 800 youth cared for by the state’s Department of Children and Family Services with histories of justice involvement.¹⁵

The city of Chicago also launched its first SIB initiative in October 2014 when Mayor Rahm Emanuel and Chicago Public Schools announced a new program to provide expanded access to early childhood education for over 2,600 Chicago public school children. The four-year, \$17 million pre-K SIB program—to be

financed by the Goldman Sachs Social Impact Fund and Northern Trust as senior lenders, and the J.B. and M.K. Pritzker Family Foundation as a subordinate lender—will use a half-day child-parent center model that works with both students and parents to improve educational outcomes and will be based in six schools serving low-income families in areas lacking publicly funded pre-K programs.

The program is similar in structure to another pre-K SIB program Goldman Sachs and Pritzker introduced in Utah in 2013 (see discussion in Reason Foundation's *Annual Privatization Report 2014*). The goals of the program are to increase kindergarten readiness, improve third-grade literacy, and reduce the need for special education services, and investors will be repaid only if students achieve positive academic results. IFF, a community development finance organization, will serve as the project coordinator and will contract with an independent evaluator to assess program outcomes. The city council approved the project in November.

- Colorado:** In June 2014, Denver Mayor Michael Hancock's administration announced that the city was developing a new, six-year, \$8 million social impact bond program aimed at reducing chronic homelessness. The city plans to partner with consultant Social Impact Solutions, the nonprofit Corporation for Supportive Housing, and the nonprofit Enterprise Community Partners on the program, and it is receiving technical assistance developing the program from Harvard University's Social Impact Bond Lab. The program aims to provide supportive housing for up to 300 homeless persons in order to reduce thousands of annual emergency room and jail visits costing the city approximately \$11 million per year, according to the *Denver Post*.¹⁶ "We expect to save taxpayers money through the life of this program," Denver Deputy Mayor and Chief Financial Officer Cary Kennedy told the *Post* in January 2015.¹⁷ "In the short term, those savings will go to repay the investors. And long term, they will go toward investing in permanent supportive housing."
- Massachusetts:** Right before leaving office in January 2015, the administration of Gov. Deval Patrick announced the launch of the Commonwealth's latest SIB initiative, a program aimed at reducing chronic homelessness by providing 500 units of supportive housing for up to 800 chronically homeless individuals over six years. The program aims to improve the well being of the homeless while saving taxpayer dollars by reducing costs for shelter and Medicaid payments. This project relies on \$1 million in philanthropic funding and \$2.5 million in

private capital investments from Santander Bank, the Corporation for Supportive Housing and United Way of Massachusetts Bay and Merrimack Valley.

“Government’s role is to help people help themselves. It is critical that we reduce the reliance on emergency services and provide individuals safe and stable housing that will help strengthen our communities and last for generations to come,” Gov. Patrick said in a press release. If the program is successful at delivering stable housing for at least one year for chronically homeless individuals participating in the initiative, the state will pay up to \$6 million to cover success payments to repay investors—with a maximum return on investment of 5.33%—as well as program evaluation and intermediary costs.

Earlier in August, the Patrick administration announced that it had selected partners with which to launch a new pay-for-success program targeting adult basic education. The Commonwealth will work with Jewish Vocational Services, a Boston-based provider of adult education and workforce development services, and Social Finance, which will serve as the project management intermediary. The initiative aims to invest approximately \$15 million in state success payments to serve some of the over 16,000 adults on the waitlist for adult basic education and English for Speakers of Other Languages programs, and the goal will be to improve participants’ employment outcomes and increase their postsecondary degree or certificate attainment over a six-year period.

- **California:** In September 2014, California Gov. Jerry Brown vetoed Senate Bill 593, legislation enacted the month before that would have authorized a social impact bond pilot program and outlined the legal framework for pay-for-success contracts to address programs or policies not currently funded by the state, to improve outcomes or lower costs in existing state programs (so long as public employees would not be displaced), to reduce recidivism, and to reduce child abuse and neglect of at-risk and foster children. The bill would have also required SIB contracts and related appropriations to be submitted to the legislature as part of the governor’s proposed budget. While recognizing that SIBs have merit, Gov. Brown vetoed the bill on grounds that the budget “is not an appropriate venue for contracts of this nature to be approved,” suggesting in his veto message that, “[i]nstead, the contract details should be at the discretion of the department authorized to implement the program.”

However, Gov. Brown did sign a separate bill—Assembly Bill 1837—that established a new Social Innovation Financing Program through 2020 allowing

the state's Board of State and Community Corrections to provide three counties with up to \$5 million in grant funding to use the SIB model for recidivism-reduction programs. Individual county grants would be no less than \$500,000, with a cap of \$2 million.

In other California news, city leaders in Richmond, California approved a new social impact bond program in October 2014 that will rely on an unusual approach: the issuance of actual municipal bonds to finance an SIB program to rehabilitate blighted housing. The city plans to issue low-interest-rate bonds to generate \$2 million in funding for the nonprofit Richmond Community Foundation to purchase and renovate blighted housing, which would then be sold to pay back the bonds.¹⁸

- **Rhode Island:** In the 2014 legislative session, a Rhode Island Senate committee approved Senate Bill 2196, which would have established a new social impact bond pilot program and study commission within the state's Department of Administration. It would have authorized the agency to develop a mechanism for an SIB project and authorized up to \$25 million toward SIBs over a five-year period. Despite passing the Senate Finance Committee, the legislation was strongly opposed by the American Federation of State, County, and Municipal Employees and did not receive a floor vote.¹⁹
- **Washington, D.C.:** In May 2014 former Mayor Vincent Gray's administration announced plans to pursue a social impact bond program targeting unplanned teen pregnancy, with Social Finance serving as an intermediary to develop the program.²⁰ The previous September, Gray's administration issued a request for proposals seeking a vendor with experience as an intermediary in social impact bond initiatives to conduct a feasibility study to explore potential applications in the District. If fully implemented, this initiative would be the first SIB in the nation to focus on teen pregnancy.

C. Higher Education Public-Private Partnerships Update

Higher education is the third largest category of state spending after Medicaid and K-12 education, accounting for 10.1% of total state expenditures in FY 2014, according to the National Association of State Budget Officers.²¹ 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. These PPP models are increasingly being used to help reduce operating costs, better maintain existing facilities and develop new and modernized academic buildings, dormitories and other campus facilities.

Perhaps the boldest example in 2014 comes from **Georgia**. In November, the Board of Regents of the University System of Georgia selected a private partner—Corvias Campus Living—to develop, construct, manage and maintain student housing in a \$517 million, 65-year concession that will span nine university campuses. Corvias will acquire and manage nearly 6,200 existing on-campus student housing beds and will develop and manage over 3,600 new on-campus beds on the nine participating campuses, totaling over three million square feet of housing. This represents the first higher education PPP deal in the U.S. to span a portfolio of campuses within a state university system.

The deal will “help maintain the affordability of housing for students and improve the fiscal health of the University System by providing financial tools and resources while reducing student-housing debt by nearly \$300 million,” according to a university system press release. As outlined in the request for proposals, the Board of Regents sought the transaction—the first phase of a broader on-campus student housing PPP initiative—to meet five key objectives:

- Ensuring affordable, safe and quality on-campus housing options for students;
- Reducing the capital lease obligations associated with existing on-campus housing;
- Providing a market-based alternative to develop and operate additional on-campus housing without incurring additional capital lease obligations;
- Leveraging private sector innovation and efficiencies in the design, construction, operation and management of on-campus housing; and
- Developing a long-term relationship between the campuses and the concessionaire to attract students to live on campus and to enhance their college experience.

The deal includes a number of noteworthy elements, including:

- Performance-based fees that tie compensation to metrics and align the interests of the concessionaire and university system;
- A reinvestment account projected to exceed \$2 billion to guarantee that all facilities are left in like-new condition at the end of the 65-year concession, and to allow each building to go through minor renovations, major renovations and full replacements five times without requiring additional capital; and
- An upfront investment of \$5.6 million into capital repairs and renovations for existing housing facilities in the first year.

The campuses participating in the PPP include Abraham Baldwin Agricultural College, Armstrong State University, College of Coastal Georgia, Columbus State University, Dalton State College, East Georgia State College, Georgia Regents University, Georgia State University and the University of North Georgia.

Other noteworthy developments on higher education PPPs in 2014 and early 2015 include:

Alaska: In August 2014, the University of Alaska-Fairbanks opened a new, \$28 million dining facility that was financed and developed by the nonprofit National Development Council. The facility is a 34,000 square-foot expansion of the existing Wood Center that includes new dining options, 320 new dining seats and a new student activities office. University Chancellor Brian Rogers told the *Fairbanks Daily News-Miner* that the project was successful—delivered on-time and on-budget through private financing—and formed the template for a PPP the university is pursuing to develop new student housing.²²

California: In early January 2015, the University of California, Merced announced that it had shortlisted three developer teams for its 2020 Project, a mixed-use development to combine academic, administrative, research, recreational, residential and student-services facilities sufficient to accommodate 10,000 students by the 2020–2021 academic year. The project will be developed across a 219-acre university-owned site that includes the current campus and 136 acres of adjacent, undeveloped land. The three teams will now develop detailed proposals, which will be submitted in late 2015. The project is aimed at cost-effectively expanding the rapidly growing, decade-old university campus, which is approaching the physical capacity of its current facilities.

Colorado: Officials at Colorado State University are currently considering a PPP as one of four potential options to develop an on-campus stadium to serve the university's football program and other sports. The analysis is the result of a two-year process to explore the feasibility of building a new stadium while limiting risk to the university's general fund by avoiding the use of tuition, fees or state funding on the project. The PPP option would involve the financing and development of a \$225 million, 42,000-seat stadium with a combination of public and private sector financing. The university's Board of Governors received a presentation on the four options in early December 2014 and, at press time, had not approved a path forward.

Florida: In October 2014, the University of Florida broke ground on the Infinity Hall PPP project, a five-story, 312-bed living learning center that will be developed, financed and managed by Signet Development. The \$23 million project is the first privately financed housing project within Innovation Square, the university's 40-acre innovation district that aims to create a sustainable live, work and play community to link the university with businesses. Infinity Hall will include collaboration spaces designed to promote idea generation and creativity, and the facility will be located across the street from the Florida Innovation Hub business incubator. The facility is expected to open before the fall semester of 2015. "Infinity Hall is the first private sector finance project to arise from the vision of public-private partnership that defines Innovation Square," University of Florida President Bernie Machen said in a press release. "Infinity Hall is the first residence hall in Gainesville—and among only a handful in the nation—designed for young entrepreneurs who mean so much to our future as a community and as a country."

In other Florida news, Seminole State College of Florida launched a procurement for a potential PPP project to finance, design, build, operate and/or maintain a new wellness center on the Sanford/Lake Mary Campus. The project would involve the modernization of an existing building and the development of programs that could include a health

clinic, pharmacy, fitness center (with coaches and class offerings), and various emotional and psychological well-being programs. Responses were due in November 2014 and were still being evaluated at press time.

Kansas: In November 2014, the University of Kansas issued a request for qualifications seeking a public-private partnership with a developer to finance, design, build, operate and maintain an array of facilities as part of its new Central District Development Project, consisting of academic science facilities, student union space, two housing facilities totaling 1,200 student beds, a power plant, and additional parking and infrastructure to support the new facilities. Qualifications from interested parties were due in December, and at press time, university officials were still evaluating submissions.

Kentucky: In September 2014, the University of Kentucky finalized a 15-year, \$245 million contract with Aramark to provide on-campus dining services. The deal includes the investment of \$70 million in renovation of existing facilities and construction of new facilities to improve access to dining, expanded vendors and options in student dining plans, job offers for all current dining employees, and an increase in the annual investment in the current locally sourced food program, among other provisions. Further, the deal will reduce prices for the university's six current student meal plans by up to 26%. “We have the opportunity to improve service, provide healthier food at lower cost to our students, invest millions in facilities and enhance our commitment to locally sourced food,” UK President Eli Capilouto said in a press release.

Two months later, Aramark invested \$5 million into a new partnership with the university to establish the Food Connection, a PPP designed to promote the production, distribution and consumption of state and local food products and fund undergraduate and graduate internships and fellowships for students in the university's College of Agriculture, Food and Environment.²³

In other Kentucky news, the Western Kentucky University Board of Regents approved the privatization of the campus health services clinic in July 2014 as a way to free up over \$1 million in the university's budget for the current fiscal year.²⁴ Graves Gilbert Clinic—a multispecialty clinic in Bowling Green—took over operations in August. The clinic has since expanded hours and days of operations and added a new psychiatrist position, and an outside volunteer advisory committee comprising students and university personnel will regularly advise Graves Gilbert on operations and potential improvements throughout the duration of the contract, according to the *College Heights Herald*.

Michigan: In June 2014, Michigan State University issued a request for proposals seeking a private partner to develop a new biomedical research center in Grand Rapids under a PPP. The university had previously shortlisted three firms to participate in the bidding for the new facility, which will occupy a portion of the former Grand Rapids Press building property. Proposals were due in July, and university officials planned to present the preferred option to the university Board of Trustees in December (though at press time the Board had not yet approved the project). If ultimately approved by trustees, the project is expected to be completed in 2017.

Nevada: The *Las Vegas Review-Journal* reported in December 2014 that Nevada's Board of Regents has approved an \$18 million public-private partnership that will see a private developer finance and build a new 610-space parking garage and university police headquarters for the University of Nevada-Las Vegas.²⁵ The project will add needed parking capacity near the campus and will expand the size of the campus police station.

Ohio: In February 2015, Ohio State University (OSU) issued a request for qualifications from firms interested in a potential 50-year lease of the university's energy system operations, which could include the private financing of energy-efficiency upgrades. OSU's current energy spending totals approximately \$100 million per year, and it faces at least \$250 million in needed energy efficiency projects, according to *Columbus Business First*.²⁶ Reducing energy spending and transferring responsibility for costly efficiency upgrades would allow the university to redirect resources toward supporting its academic mission (e.g., scholarships, research, etc.), according to officials. Responses are due from interested bidders in early April.

Texas: In June 2014, Texas A&M University reached financial close on a \$104 million, 1,274-bed student housing PPP project for its main College Station campus. The project, to be developed by Balfour Beatty Campus Solutions and expected to be ready for the fall semester of 2015, will include apartment-style housing units, along with residence life offices and other student amenities.

Earlier that month, Astin Limited took over operations of Texas A&M's Easterwood Airport in a 10-year contract that will see the firm invest \$7 million in capital improvements that may include modernizing the McKenzie and general aviation terminals, adding a new multi-purpose hangar, and upgrading existing airport hangars, according to a university press release. University officials anticipate that most airport employees will transition to the private operator.

In other Texas news, Tarleton State University reached financial close in July 2014 on a \$38 million second phase of a student housing PPP project in which Balfour Beatty Campus Solutions will develop a new 502-bed student housing facility and renovate an existing 80-bed facility on the university's Stephenville campus. Last year, the university embarked on the first phase of the project, a new \$25 million, 514-bed housing facility also being developed by Balfour Beatty. Both phases of the project are being financed through an issuance of tax-exempt bonds underwritten by RBC Capital Markets, and it will be owned by an affiliate of the nonprofit Collegiate Housing Foundation under a 32-year ground lease with the university.

D. Privatized State Lottery Management Update

Outsourcing is ubiquitous among the 44 states that currently operate lotteries; what separates them is the degree to which each lottery partners with the private sector. All of them currently contract out certain aspects of their internal lottery operations, such as central data systems, lottery terminals, instant ticket printing and distribution, vending machines and advertising.

However, three states—Illinois, Indiana and New Jersey—have taken the outsourcing concept further in recent years by entering into private management agreements (PMAs) with gaming service providers, which are designed to increase net lottery revenues to the state as a central feature of the contracts. While the standing interpretation of federal law is that full privatization (through outright sales) or long-term commercial leases of state lotteries are prohibited, PMAs have been construed as legal since in each of the three cases, the state retains the ultimate business decision-making authority and remains the predominant beneficiary of lottery proceeds, generally interpreted as approximately 95% of net revenues.

While no new state embarked on a lottery PMA in 2014, there were some significant developments in the lottery marketplace, particularly with regard to the varied experiences of Illinois, Indiana and New Jersey in implementation.

Most significantly, **Illinois**—the first state to enter into a PMA in 2011 with commitments from the private manager to increase net lottery revenues to the state—announced plans in August 2014 to cancel its lottery contract with Northstar after the private manager missed its revenue targets for the third straight year. As discussed in recent editions of Reason Foundation's *Annual Privatization Report*, the client-vendor relationship was on shaky ground almost from the beginning of the contract in 2011, and the two parties never ultimately agreed on final annual revenue figures since the beginning of the contract, an issue that was never resolved in arbitration.

Another source of tension has been Northstar's unsuccessful pursuit of changes to the targets agreed to in the original contract to reflect what it saw as certain state actions that limited its ability to execute parts of its annual business plans. Further, the Illinois PMA contract set forth a challenging management situation in which the sales representatives that worked for the state prior to the contract remained state employees after privatization, but were managed by Northstar, which limited the discretion and

control the company had over that portion of the workforce, particularly with regard to issues like incentive pay and workplace rules.

Notably, despite missing the contracted targets, in each year of the contract Northstar consistently brought in more net revenue to the state relative to what the lottery had returned when it was under state management. A few months prior to the contract cancellation, a Northstar official told the state's Lottery Control Board that net revenues to the state had increased by approximately \$450 million since the contract began in 2011, representing a 12% annual growth in sales (compared to 3% under state operation), according to the *Chicago Tribune*.²⁷

In December 2014, the state and Northstar announced that the two parties had reached an agreement to officially end the contract and resolve litigation that included provisions for the state to pay Northstar a termination for convenience fee of up to \$12.65 million and a disentanglement services fee of approximately \$121 million to reimburse costs for ongoing operating expenses for personnel, subcontractors and other expenses during the 12-month unwinding of the contract. However, the following month, state Attorney General Lisa Madigan issued a letter rejecting the deal on grounds that it violated the state Constitution and provisions of the state public-records act, adding that it was also invalid because the two parties had previously been in litigation, and thus only the attorney general—not the lottery agency—had the authority to approve a settlement.²⁸

The proposed settlement—negotiated in the final months of former Gov. Pat Quinn's term—was also criticized by the incoming administration of Gov. Bruce Rauner as a bad deal for taxpayers. While the Illinois Lottery had originally announced plans to rebid the PMA contract to seek another operator, at press time those plans remained in limbo, and the impact of Madigan's rejection of the proposed settlement was still uncertain.

In contrast to the situation in Illinois, the first full year of **Indiana's** lottery PMA was remarkably smooth and appears to be proceeding with a relatively amicable client-vendor relationship. Indiana was the first state to follow Illinois's lead, approving a private management agreement (PMA) for its lottery in the fall of 2012, and officially launching in July 2013. In the Hoosier Lottery's 15-year PMA with GTECH Indiana, the company is providing expanded lottery marketing, sales, customer service and distribution services and has committed to generating an additional \$2.1 billion for the state over the life of the contract relative to in-house operation (and approximately \$500 million of additional net income over the first five years).

According to *The Indianapolis Star*, GTECH—which was part of the Northstar consortium in Illinois—delivered a record \$251 million in net revenues to the state in its first year of a 15-year contract, representing a 12% increase over the \$224 million delivered to the state under its last year of in-house operation.²⁹ Gross revenues were up 9% to over \$1 billion relative to the high achieved under state operation.³⁰

Nonetheless, the private manager came in just shy of hitting its first year target—by a margin of less than 1%—and it made a \$1.6 million payment to the state to cover the difference.³¹ In August 2014, William Zielke, chairman of Indiana’s state lottery commission, told *The Times*, “I consider this first year to be a huge success. [...] This contract, from my perspective, worked exactly as it was supposed to work.”

Despite nearly hitting its target in the first year of Indiana’s PMA, there are signs that it may be difficult for GTECH to reach its ambitious second year target of \$320 million in net revenues. In a press release to investors in November 2014, the company suggested that lower-than-expected multistate jackpot gaming—particularly sluggish sales of the new Monopoly Millionaires’ Club game—was expected to yield a revenue shortfall that could result in the company making the maximum shortfall payment to the state of \$16 million (or 5% of the net revenue target) for the fiscal year ending in June 2015.³²

Lower-than-expected revenues in multistate games—particularly the Powerball game, which saw a 35% decline in total revenues in 2014 relative to the previous year—appear to have also affected the first year of **New Jersey’s** lottery PMA, which saw a gap between revenue targets and actual net revenues to the state.³³

As detailed in Reason Foundation’s *Annual Privatization Report 2014*, New Jersey became the third state to enter into a private management agreement in June 2013, signing a 15-year contract with Northstar New Jersey Lottery Group—a joint venture of GTECH, Scientific Games and the Ontario Municipal Employees Retirement System—to take over marketing and sales functions in return for a \$120 million upfront payment and a contractual commitment to generate at least \$1.42 billion in additional net income for the state over the life of the contract, relative to in-house operation. The state retained control over security, oversight, licensing, auditing and prize payments.

Though at press time the state had not issued a public statement regarding the first year results of the PMA, the New Jersey Lottery’s financial statement for the 2014 fiscal year—capturing the first nine months of the PMA, which officially launched in October 2013—showed that the Northstar-operated lottery had transferred \$965 million in net proceeds to the state in FY2014, equaling the amount the state-run lottery had delivered the previous year in FY2013 (after subtracting the one-time \$120 million upfront

payment from Northstar that fiscal year) and exceeding the \$950 million the lottery delivered to the state in FY2012.³⁴

However, this was \$55 million lower than the net revenue target for FY2014, triggering a shortfall payment to the state from Northstar of \$14.1 million that was deducted from a \$20 million shortfall reserve account established at the beginning of the PMA contract.

Digging deeper into the New Jersey Lottery's FY 2014 financial statement:

- Total ticket sales and lottery operating revenue were up nearly 3% under the PMA. Total operating revenue reached \$2.94 billion in FY2014, compared to \$2.86 billion in FY2013 (the last year of state operation) and \$2.80 billion in FY2012.
- Ticket sales in every category were up in FY2014, with the notable exception of a \$66.7 million year-over-year decline in Powerball sales in FY2014.
- Total operating expenses were also up under the PMA by approximately 4.6%, rising from \$1.899 billion in FY2013 to \$1.986 billion in FY2014 relative to the previous year. The primary factors in the \$87 million increase were a \$63 million year-over-year increase in prize awards, a \$10 million increase in vendor fees, a \$4 million increase in retailer commissions, and \$29 million in fees and expenses paid to Northstar in FY2014. The \$29 million paid to Northstar includes \$16.3 million in advertising and marketing expenses, \$9.4 million in manager expenses, and a \$3.5 million management fee. Meanwhile, the lottery's other administrative expenses dropped by \$19 million in FY2014.

As the New Jersey Lottery PMA began its second year (and first full year) in July 2014, a state appellate panel rejected a labor union's legal challenge to the PMA. The Communications Workers of America—the largest union representing state government workers in New Jersey, including former state lottery employees—challenged the constitutionality of the contract contending that state law required the lottery to be operated by the state only; the lawsuit also challenged the legality of the annual management fee paid to Northstar.³⁵ According to the *New Jersey Law Journal*, the three-judge panel rejected both arguments, finding that the state still retained control of the lottery despite contracting out certain functions and that the management fee was properly applied.³⁶

Overall, with the cancellation of Illinois's PMA contract (and a lack of progress on a potential re-bid), Indiana and New Jersey are likely to remain the only two states with active lottery PMAs in 2015. However, two **Michigan** legislators have introduced companion bills in the 2015 legislative session that would require the state lottery to solicit bids for a potential PMA. "There's a lot of good things that the state of Michigan and its employees do," State Sen. Wayne Schmidt told the *Lansing State Journal* in February 2015.³⁷ "Personally, I think the lottery would be one of those that should be more in the private sector." Schmidt sponsored one of the two bills (Senate Bill 75), and State Rep. Earl Poleski sponsored the companion bill in the House (House Bill 4077). At press time, both bills were awaiting a hearing in committee.

E. State Liquor Privatization Update

Since the end of Prohibition in 1933, most states have chosen to regulate the private distribution and sale of distilled spirits through licensing and other requirements, but some so-called “control” states have gone further by maintaining some form of government-owned wholesale and/or retail monopoly in the distilled spirits market.

Currently:

- A total of 33 “license” states allow private firms to distribute and sell distilled spirits.
- There are 17 “control” states that retain a government-run monopoly on the sale and/or distribution of distilled spirits: Alabama, Idaho, Iowa, Maine, Michigan, Mississippi, Montana, New Hampshire, North Carolina, Ohio, Oregon, Pennsylvania, Utah, Vermont, Virginia, West Virginia and Wyoming. Additionally, two counties in Maryland (Montgomery and Worcester Counties) operate local government-run liquor wholesale and retail enterprises, though overall Maryland is considered a “license” state.

The public-private landscape in the distribution and sale of distilled spirits has been remarkably static since 1933. While some privatization has occurred in the interim, no state has ever shifted from a private regime to a state-run liquor monopoly, and there is even a significant degree of privatization in some “control” states:

- In June 2012, Washington State became the first state since the end of Prohibition to fully privatize its state-run wholesale and retail spirits monopolies, the result of a ballot measure (Initiative 1183) enacted by voters in 2011.
- Maine has outsourced the operation of its spirits wholesale monopoly to a private manager since 2004.
- Iowa and West Virginia fully privatized their spirits retail monopoly in recent decades, while retaining their in-house wholesale operation. They joined three other states—Michigan, Mississippi and Wyoming—that could be considered wholesale “control”/private “license” states.
- 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.

- Retail liquor operations in three states—Idaho, New Hampshire and Utah—is a blend of state-owned and operated retail outlets and agency/contract stores.
- Alabama uses a blend of state-run liquor stores and private, licensed retail outlets.
- Three states—North Carolina, Pennsylvania and Virginia—limit spirits sales exclusively to state-run retail stores.

1. State Liquor Privatization Roundup

Noteworthy developments in liquor privatization over the past year include:

Washington State

June 2014 marked the beginning of the third year of privatized sales and distribution of distilled spirits in Washington State after the passage of Initiative 1183 (I-1183) in 2011, which fully privatized the wholesale and retail markets. Under I-1183, the state privatized its nearly 330 retail outlets and issued licenses for spirits sales at approximately 1,500 stores statewide, primarily large outlets like grocery stores, wholesale clubs and national alcohol retail chains. The initiative also opened up the wholesale market to competition, allowing retailers to buy spirits and wine directly from manufacturers or wholesalers (while preserving the existing mandate that retailers purchase beer from wholesalers).

While the transition to privatization was fairly smooth overall given the massive change inherent in disrupting a major statewide marketplace, there was significant price volatility in the first year 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. This led to some degree of “sticker shock” as spirits prices rose for many types of products (though some retailers have reported lower prices on certain products after privatization, indicating price hikes have not been universal).

According to data compiled by the Washington State Department of Revenue (see Table 1), the average price per liter of spirits has increased by approximately 12% since the onset of privatization, from an average of \$20.78 in FY 2012 (the year before privatization) to \$23.28 in FY2014 (the second full year of privatization); the vast majority of this increase occurred in the first year of privatization, as prices remained

steady through the second year. Post-privatization price increases led to a commensurate increase in spirits-related tax revenues from \$241.7 million in FY 2012 to \$267.4 million in FY 2014.

	Spirits-Related Tax Revenues (millions)	Percent Change	Spirits Sales (million liters sold)	Percent Change	Average Price Per Liter (after taxes)	Percent Change
FY2012	\$241.7	--	39.5	--	\$20.78	--
FY2013	\$265.2	9.72%	39.8	0.76%	\$23.23	11.8%
FY2014	\$267.4	0.83%	40.1	0.75%	\$23.28	0.2%
FY2015 (partial, June-Oct 2014)	n/a	--	n/a	--	\$22.89	-1.7%

Source: Washington State Department of Revenue, various datasets.

Notes: Privatization took effect on June 1, 2012, coinciding with the start of Fiscal Year 2013. "Total revenues" combines sales and per-liter taxes levied on distilled spirits. "Total spirits sales" includes sales to consumers through spirits retailers and sales to on-premise licensees through spirits distributors.

Notably, spirits sales have barely moved since privatization, rising 1.5% from 39.5 million liters sold in FY 2012 to 40.1 million liters sold in FY 2014. This suggests that consumption-related fears raised by some I-1183 opponents—namely, that privatization would lead to dramatic increases in spirits sales due to increased availability—are unfounded.

Despite the initial jump in average spirits prices after privatization, the reduction in the 10% wholesaler fee (halved to 5%) that occurred in June 2014 is expected to put downward pressure on prices. At press time, the early data for the first five months of FY 2015 suggest that this price moderation may be underway, as the average per-liter price of spirits has declined to \$22.89 during that time (see Table 1).

In addition to the average increase in spirits prices, there has been considerable contention over the application of the new 17% retail license fee. Retailers and on-premise spirits licensees (e.g., restaurants and bars) have complained that retailers are at a disadvantage in selling spirits to restaurants and bars as compared to spirits distributors, as the former is required to pay the 17% fee, while the latter pays a lower 10% (recently halved to 5%) fee. In 2013, the state legislature exempted former state contract store owners and those who bought former state-owned spirits stores at auction from this requirement, while leaving it in place for the large retail licensees that dominate the market. According to opponents of this policy, this situation places large retailers at a disadvantage and harms rural restaurants by penalizing them for making

retail purchases instead of relying on less frequent rural deliveries by distributors; they also argue that this application of the 17% fee was not specified in I-1183 itself, but was rather an administrative interpretation by the state's Liquor Control Board.³⁸

In the 2014 legislative session, the state Senate passed a bill (Senate Bill 6220) that would have addressed this issue by exempting spirits retail licensees from paying the 17% license issuance fee on sales to on-premise spirits licensees and requiring that the distributor's license issuance fee be paid only by the first entity in the state to possess the spirits on which the fee is levied. The bill languished in the House and failed to pass.

There has been additional conflict between distributors, retailers and on-premise licensees related to the issue of “channel pricing,” or preferential pricing that distributors typically offer to restaurants and bars, but not retail outlets. The state Liquor Control Board initially rejected this practice and set forth to prohibit it, but reversed course in 2014 and adopted a policy that explicitly allows distributors to offer discounts to restaurants and bars based on volume.³⁹ However, the ruling left many industry participants disappointed: retailers—particularly small spirits stores—complained that the price breaks would make it less likely that restaurants and bars would buy from them, while restaurants complained that discounts were limited to only volume purchases.⁴⁰

Privatization also does not appear to have imposed significant social costs on the state. Many opponents feared that opening the spirits market would lead to an increase in associated social costs like binge drinking, underage alcohol abuse and DUI incidents. As discussed in Reason Foundation's *Annual Privatization Report 2014*, alcohol-related arrests in most categories—such as DUI collisions, DUI arrests, and minor in possession charges—have continued on a downward trend since privatization, as have alcohol-related driver fatalities.

An outside study funded by the Robert Wood Johnson Foundation and undertaken by government health officials in Washington and Oregon was released in 2014 and suggested that alcohol-related emergency room visits have increased substantially since privatization (though it did not distinguish between different types of alcohol). However, George Mason University's Statistical Assessment Service Executive Director Donald Rieck called the findings into question, suggesting that they were “less a study [...] than a PowerPoint presentation of preliminary data by long-term opponents of privatization,” adding that “the preponderance of data on the effects of privatization on Washington State suggests the exact opposite” of the negative effects cited in the research.⁴¹

Pennsylvania

Though outgoing Gov. Tom Corbett and many in the state's Republican legislative majority have long supported privatizing Pennsylvania's wholesale and retail liquor monopolies—as do a majority of Pennsylvania citizens—2014 ended the same as it has every year since 2011: with no substantive progress on liquor privatization.

After the House passed an aggressive privatization bill in 2013 that would have ended the state's wholesale monopoly, created 1,200 private retail and distribution licenses, and gradually closed the hundreds of state-owned stores, the Senate balked in 2013 and refused to consider the legislation again in 2014. The House tried a different tack in 2014 by adopting a budget plan that assumed an influx of revenue from the sale of the state's liquor wholesale and retail operations, yet the proposal died in the Senate and was not included in the final passed budget. Meanwhile, the Senate debated “privatization lite” legislation that would have opened up beer and wine sales to grocery stores, allowed convenience stores to sell beer, and left the state's liquor retail stores to remain in operation, but it failed to achieve a political consensus before the end of the legislative session.

With the recent inauguration of Gov. Tom Wolf, a privatization opponent, it remains unclear whether or not the issue will advance in the coming years. On the campaign trail, Wolf expressed support for modernizing—not privatizing—the state's liquor monopoly, even suggesting a potential expansion of the Commonwealth's wholesale monopoly to other states.⁴² However, new House Speaker Mike Turzai—sponsor of the 2013 House privatization bill and leading privatization advocate—has suggested that liquor privatization could be a primary bargaining chip with the Wolf administration as it seeks to compromise with the legislature over the new governor's desire to implement a natural gas extraction tax.⁴³

To that end, Speaker Turzai introduced House Bill 466—a liquor privatization bill very similar to the 2013 bill that passed the House but languished in the Senate the next year—in the 2015 legislative session. In late February 2015, the House passed HB 466 by a 114–87 margin. Like its predecessor, the bill would privatize Pennsylvania's state wholesale wine and spirits monopoly, gradually close the hundreds of state-owned liquor stores, and create 1,200 private retail and distribution licenses for wine and spirits. It would leave intact the Commonwealth's current liquor taxation structure: an 18% liquor tax and 6% sales tax.

Given the state's budget deficit, the ability to generate one-time revenues from licensing private retailers and wholesalers is a significant aspect of the political calculation.

According to the fiscal note on the bill released by the House Appropriations Committee, HB 466 would produce an estimated \$1.167 billion in one-time license fees, consisting of:

- \$615.6 million in wine and spirits wholesale license and application fees;
- \$404.6 million from retail wine and spirits store license fees;
- \$138.2 million in grocery store license fees; and
- \$9.0 million in retail dispenser license upgrade fees.

The fiscal note for HB 466 did not include estimates of one-time revenues from asset sales related to current state wholesale and retail operations.

At press time, HB 466 had not been heard in the Senate. Despite the perennial failures to advance liquor privatization in the political process, Pennsylvania voters remain supportive of the idea. A January 2015 poll of registered voters published by Mercyhurst University's Center for Applied Politics found that 52% supported liquor privatization, with only 34% opposed.⁴⁴

Oregon

Having watched the successful passage of Washington State's liquor privatization initiative in 2011, Oregonians for Competition—a group backed by the Northwest Grocery Association—filed five different initiative petitions in December 2013 to end the state-run liquor monopoly and expand the sale of distilled spirits to retail outlets over 10,000 square feet. The group ultimately narrowed this down to two separate ballot initiatives on liquor privatization, but legal issues prompted them to withdraw both measures in advance of the signature-gathering deadline in June 2014. The previous month, the state Supreme Court rejected the ballot title for the proponents' preferred initiative, and rather than proceed with signature gathering for the second measure, they opted to drop the initiative drive for 2014 and seek privatization legislation in 2015 (and a 2016 ballot measure if that fails).⁴⁵

Utah

Though Utah is generally viewed as the most aggressive “control” state—all spirits, wine and beer over 4% alcohol are sold through the state's retail alcohol monopoly—voters are of a mixed mind about the system and generally support some form of privatization. A November 2014 poll of active voters by UtahPolicy.com found that a

slight plurality (36%) of Utahns think the state should privatize all liquor sales, while another 27% would prefer the state to retain control over distilled spirits sales while privatizing retail sales of beer and wine. Only 31% of respondents preferred the status quo.⁴⁶

In contrast to some other states, a majority of Democrats (64%) supported privatization, compared to only 26% of Republicans and 38% of independent voters. Meanwhile, 40% of Republicans prefer the status quo of state control, compared to 27% of independent voters and 6% of Democrats. Notably, the survey found that 46% of very active Mormons want Utah to maintain its control state status, while 56% of somewhat active Latter Day Saints (LDS) Church members and 54% of inactive LDS Churchgoers prefer full privatization.

Maryland (Montgomery County)

In December 2014, the Montgomery County Council created an ad hoc committee to examine the county's monopoly on the sale and distribution of distilled spirits. Prompted by local news reports of theft and workplace drinking by employees of the county liquor control agency, the committee will explore a range of liquor control issues. "I want people to understand that the creation of this ad hoc committee is not in and of itself a call for privatization of the department," Council President Leventhal told *The Sentinel*. "We will look at privatization of the department, along with a wide range of other issues—how can we be competitive, how can we have a lively nightlife, how can we have a lively restaurant scene, how can Montgomery County consumers get access to a wide range of product."⁴⁷

Earlier in the year, Maryland State Comptroller Peter Franchot called for the county to dismantle its spirits distribution monopoly at a meeting of the Bethesda-Chevy Chase Chamber of Commerce's board. "It's long overdue for Montgomery County to get out of the beer, wine and spirits business," Franchot noted in a statement. "It's an outdated, inconvenient and inefficient system of public alcohol control that severely inhibits consumer choice and causes unnecessary bureaucratic hurdles for small businesses."⁴⁸

F. State Child Welfare Privatization Update

In 2014 several states continued to face challenges with their child welfare privatization implementation efforts.

Georgia

In Georgia plans to privatize most of the state's child welfare system were unsuccessful in March 2014 when legislators in the House decided not to consider a bill approved by the Senate that would implement a three-year pilot program to privatize adoption and foster care services.

Later that year, Governor Nathan Deal organized a Child Welfare Reform Council to consider how to reform child welfare in Georgia. The Child Welfare Reform Council's final January 2015 report did not include privatization as a potential mechanism for reforming child welfare in Georgia. Instead the report focused on child safety reforms including creating a more effective child abuse registry, developing technology for a "Panic Button" that caseworkers could use in dangerous situations, and adding performance and pay incentives to help retain caseworkers.⁴⁹

More recently, State Senator Renee Unterman, R-Buford, who supported the 2014 attempt to privatize Georgia's child welfare system, introduced a new, smaller plan to bypass the state's foster care system. Senate Bill 3, which was passed by the Senate on February 10, would allow a parent to give permission for temporary custody to another person to care for the child for one year without a court order of guardianship.⁵⁰ The bill would also extend that ability to military service members. "They can find a family or reach out to someone they know and give them temporary power of attorney," Unterman told the *Atlanta-Journal Constitution*.⁵¹ The temporary custody agreements would be managed by nonprofit organizations that specialize in crisis intervention and would bypass the state's Division of Family and Children's Services.⁵²

Nebraska

The future of child welfare privatization in Nebraska continues to be an open question. In 2009 the state hired five lead agencies to provide services for children in the child welfare system in different geographic regions of the state. By 2012, four of the five providers had their contracts terminated because of shortfalls in state funding to cover program costs and an unmanageable number of children in the system. The state now provides child welfare services in every region except in the Omaha area.⁵³

In 2014, the state contracted with Hornby Zeller Associates to conduct an independent evaluation of the remaining private contractor, Nebraska Families Collaborative, which provides child welfare case management in the Eastern region covering the Omaha area.

Omaha Senator Bob Krist authorized the evaluation as part of a contract extension for the Nebraska Families Collaborative through 2014 legislation (LB660) to determine whether all child welfare services in Nebraska should be managed by the Department of Health and Human Services or whether privatization was working in the Omaha region.

The Nebraska Families Collaborative (NFC) actually had lower costs compared to the state's management costs in the child welfare regions other than Omaha. NFC's costs were \$48.10 per child per day while the state's costs were \$74.17.⁵⁴ Senator Bob Krist argued that the state's costs were higher because of the added costs of retaking control of management of the child welfare system from the other private contractors.⁵⁵

NFC also had slightly better compliance with child welfare regulations than in those regions where the state governed child-welfare services. However, the report found that there was no measurable difference in the performance outcomes for the children and families managed by NFC as compared to state management.

Dave Newell, president and CEO of the collaborative, told the *Lincoln Journal Star* that's he was disappointed in the report. He argued that children and families in Douglas and Sarpy counties are achieving the best child welfare results in their history and the collaborative is needed to continue to build on the progress. "Despite NFC only serving the Eastern Service Area, as a whole, since March 2012, our region has been transformed from being the historically lowest performing child welfare system in Nebraska to being on par with or better than the other service areas for the very first time," Newell told the *Journal Star*.⁵⁶

The study compared current outcomes for the Omaha area with the rest of the state, but it did not compare current outcomes for the Omaha area with those of previous years. The evaluation would have been more accurate if it conducted a value-added assessment and measured outcomes for children in Omaha in the Eastern region before and after the privatization efforts by examining the state's actual data on federal performance indicators. In fact, the Department of Health and Human Services data reveal that the NFC has significantly better performance over time in the Eastern region than before privatization on almost every federal performance measure, including absence of the recurrence of maltreatment (less repeat child abuse), much faster permanency and family reunification, adoptions on a faster timeline, better overall permanency for children in foster care, and significantly higher placement stability over time than before the pilot project.⁵⁷ Before the privatization efforts Omaha had outcomes that were far below other jurisdictions in the state, and by June 2014 those indicators were on a par or in some cases higher than other regions in the state.

Texas

In 2014, Texas continued to struggle with its implementation of the state's foster care redesign initiative. The reform effort would assign lead contractors, within specific geographic regions, to improve the overall well-being of children in the child welfare system to help them live safely closer to home and stay connected with their siblings and communities.

The Department of Family and Protective Services (DFPS) formally launched the foster care redesign in 2013. To date the only geographic region of the statewide effort that has been successfully implemented is led by a Fort Worth nonprofit, ACH Child and Family Services, under a three-year contract that took effect January 1, 2014. The ACH contract includes child welfare management in seven counties (Tarrant, Johnson, Parker, Palo Pinto, Hood, Somervell and Erath) for approximately 3,000 children. Wayne Carson, the nonprofit's CEO, told the *Fort Worth Star Telegram* in December 2014 that state funding came up \$1.2 million short of covering the first year's costs.⁵⁸ Even with the shortfall, ACH is currently committed to implementing the goals of the foster care redesign.

Providence Service Corp. took on the same responsibilities in a region centered near Abilene beginning in August 2013. Providence withdrew a year later after failing to secure more state funding. In September 2014, a third-party analysis conducted by Boston consulting firm Public Consulting Group concluded that additional funds to

develop and fund the capacity of lead providers are required for the new foster care redesign model to succeed.⁵⁹

In January 2015, the Texas House and Human Services Committee suggested that the state temporarily stop the rollout of reforms to the child welfare system and recommended that the Department of Family and Protective Services should reconsider private management of the foster care system. It also called for more research and studies by the state legislature to determine the effectiveness of child welfare privatization to date and wants to pause the privatization efforts in the state's other 247 counties.⁶⁰ The ACH Family Service contract will continue and is not affected by the committee recommendation.

G. State Privatization News and Notes

Arizona

In June 2014, the Arizona Department of Transportation announced a new “Safe Phone Zones” driver safety program in which insurance company GEICO will sponsor a series of signs pointing drivers to state highway rest areas to use their cell phones for calls, texts and mobile app use. This is the first sponsorship program developed under the state’s five-year public-private partnership with Infrastructure Corporation of America for the operations and maintenance of 14 state rest areas. “These Safe Phone Zones provide travelers with the opportunity to pull into a rest area where they can use their phones safely and responsibly,” ADOT Director John Halikowski noted in a press release. “We are able to move this project forward because of the legislation enacted to generate public-private partnerships in Arizona—partnerships that have proven to be an innovative approach to funding transportation projects with non-traditional funding sources.”

Later in the year, ADOT issued a request for information seeking interested consultants to potentially implement a five-year corporate sponsorship program for state transportation assets to help offset operating costs and/or enhance revenue streams. Potential assets and facilities contemplated for the sponsorship program include sections of state highway systems, interchanges, freeway patrol vehicles, traffic images and data, the 511 traveler information program, the Motor Vehicle Department, ports of entry, websites, office space merchandising, the Grand Canyon National Park Airport and the Adopt a Highway program. If the project proceeds, the consultant’s responsibilities would include marketing, sales, development of fee schedules and revenue collection.

In other Arizona news, the Central Arizona Groundwater Replenishment District (CAGRDR)—the groundwater replenishment authority of the Central Arizona Project—announced an agreement with Liberty Utilities in November 2014 to build the state’s first-ever reclaimed water recharge facility through a PPP. The project—which will help CAGRDR meet its legal groundwater replenishment obligations with a 100-year, renewable water supply—will send reclaimed water from Liberty’s Palm Valley Water Reclamation Plant to a new aquifer recharge facility to be built in Goodyear, where the water will be pumped into large, shallow basins to replenish the local aquifer and help restore water levels that have declined due to past pumping.

California

In April 2014, the California Assembly passed House Resolution 29, a non-binding resolution sponsored by the American Federation of State, County, and Municipal Employees union that states that “the Assembly opposes outsourcing of public services and assets, which harms transparency, accountability, shared prosperity, and competition, and supports processes that give public service workers the opportunity to develop their own plan on how to deliver cost-effective, high-quality services.” Dozens of different organizations representing local governments registered opposition to the bill—including the League of California Cities, California Contract Cities Association, California Chamber of Commerce, and over 40 cities and towns—fearing that the resolution could be the first step toward limiting local governments’ ability to address ongoing fiscal challenges through solutions like privatization.

Later that September, Gov. Jerry Brown vetoed two bills sponsored by Assemblyman Richard Pan that would have imposed new limitations on state agency contracting:

- Assembly Bill 1574, which would have prevented state agencies from entering into personal services contracts that guarantee payment for services not provided and would have prevented such contracts from providing for guaranteed occupancy rates for private prisons, dormitories or any other contracted facilities, among other provisions. In his veto message, Brown explained that the legislation “would limit the state's ability to make advance payments to community-based nonprofit groups, and could invite litigation challenging the validity of existing public contracts,” as well as restrict the state Department of Corrections and Rehabilitation’s ability to execute contracts to comply with court-ordered prison population caps and other legal mandates.
- Assembly Bill 1575, which would have required any personal services contract to incorporate specific performance criteria and cost parameters and required contractors to submit quarterly reports to the relevant state agency’s contracting official on their compliance with the performance criteria and actual amounts billed to the state agency. Failure to comply would have become grounds for a contract’s cancellation. In his veto message, Brown explained that current law already allowed agencies sufficient discretion to require contractor reporting, adding that “I don't believe we should mandate additional paperwork without a clear benefit, which I don't find to be the case here.”

Connecticut

The Connecticut Senate considered, but did not take action on, a bill that would have expanded the range of privatization contracts for which a cost-benefit analysis and business case would be required. This requirement applies only to contracts for a service provided entirely by state employees under current law, but Senate Bill 351 would have expanded that to services provided in part by public employees, as well as to renewals of contracts in existence before June 2010 covering services previously provided entirely by state employees.

Florida

After the Florida legislature approved the statewide privatization of its Medicaid program in 2011—essentially extending a five-county pilot program in Medicaid managed care begun in 2006 under former Gov. Jeb Bush to all counties across the state—the state’s Agency for Health Care Administration announced in August 2014 that it had completed the full rollout of its Statewide Medicaid Managed Care program ahead of schedule. The agency also announced that the federal government had approved an extension of a waiver allowing the state to continue operating the program through June 2017. The agency anticipates approximately \$2 billion in cost savings over that time period. Officials estimate that the program is now covering approximately three million state Medicaid recipients.

According to state officials, the managed care privatization program is rooted in four key objectives:

- Improving outcomes through coordinated care, patient engagement in their own health care, and fiscal responsibility.
- Improving program performance by increasing patient satisfaction.
- Improving access by enrolling all eligible Medicaid beneficiaries in managed care.
- Enhancing fiscal predictability and financial management through the use of capitated, risk-adjusted payment systems, with strict financial oversight requirements for managed care organizations.

Georgia

The Georgia General Assembly enacted social infrastructure PPP-enabling legislation in the 2015 session, after a similar bill came close to passage in 2014. The Partnership for Public Facilities and Infrastructure Act (Senate Bill 59), sponsored by Sen. Hunter Hill, authorizes state agencies, local governments, school boards and other governmental units to use PPPs to develop any infrastructure project on government-owned or leased land that serves a public purpose and would also create a Partnership for Public Facilities and Infrastructure Act Guidelines Committee to prepare model guidelines for governmental authorities to use in developing PPP projects. The bill passed the Senate and the House Committee on Governmental Affairs in 2014 but failed to receive a vote in the full House. For the final enacted bill, 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, according to the *Atlanta Business Chronicle*.⁶¹ At press time, the bill was awaiting consideration by Gov. Nathan Deal.

Hawaii

For the second year in a row, legislation in Hawaii that would have established a new public-private finance initiative and authorized a pilot public-private partnership project passed both legislative chambers but failed to be enacted. Senate Bill 3066 passed both the House and Senate, but the two chambers were unable to reach agreement on their respective amendments to the bill before the end of the legislative session.

However, the issue will return in the 2015 legislative session, where several proposed bills—including House Bill 1483 and Senate Bill 1375—would establish a legal framework for public facility public-private partnerships. Additionally, the legislature will consider Senate Bill 795, which would authorize the Maui region of the state-run Hawaii Health Systems Corporation (HHSC) to enter into an agreement with a private entity to transition one or more of its facilities—including the Maui Memorial Medical Center, Kula hospital, and Lanai community hospital—into a new private, nonprofit corporation. HHSC is currently facing a \$46 million budget deficit and in January 2015 announced that it was pursuing a public-private partnership with the private, nonprofit Hawaii Public Health to take over operations of the Maui Memorial Medical Center.⁶²

Idaho

In July 2014, the Idaho legislature's Office of Performance Evaluations (OPE) issued a follow-up report to the Joint Legislative Oversight Committee citing improvements in state contract management as a result of recently enacted legislation and agency action in the wake of a critical 2013 OPE evaluation report that found inconsistent contract training and a lack of a formal framework for contract monitoring among agencies.⁶³ In response to the 2013 report, legislators passed four pieces of legislation intended to address the problems cited, including a resolution directing the Idaho Department of Administration (IDOA) to develop a plan to address findings in the audit, as well as language in the agency's 2015 appropriations bill requiring the department to develop a best practices checklist and a statewide monitoring system.

As a result, the IDOA's Division of Purchasing conducted an internal review of contract planning and management practices and developed a plan to improve the state's contracting process focused on major service contracts with a value of over \$5 million. Even though such contracts only accounted for 45 of the 831 active contracts overseen by the Division, their \$2.6 billion in contract value accounted for over 80% of the total value of all contracts. OPE evaluators found the enhanced planning and monitoring requirements proposed by the Division "to be an adequate and practical framework for contract monitoring," according to an OPE press release.

Illinois

Shortly upon taking office in January 2015, Illinois Gov. Bruce Rauner issued his first executive order (Executive Order 15-08), a sweeping directive calling for a freeze on all state discretionary spending, an inventory of current state contracts, a moratorium on new state contract and grant awards, an inventory of surplus state property that can be sold, and the development of a strategy to consolidate state office space. The order also directed agencies to halt sales or leases of new motor vehicles, stop out-of-state travel, and limit in-state travel. "Years of bad decisions have put Illinois in a financial crisis," Rauner said in a press release. "Today we start the process of putting our state back on the road to fiscal stability by reviewing agency spending, stopping contracts and grants, and selling excess state property."

Indiana

In October 2014, the Indiana Supreme Court heard the long-simmering dispute between the state and IBM over the early cancellation of a 2006 contract to modernize the state's welfare eligibility system. However, the two parties subsequently agreed to seek mediation, following a recommendation made by Chief Justice Loretta Rush to help resolve the dispute.⁶⁴

As discussed in recent editions of Reason Foundation's *Annual Privatization Report*, Indiana launched a 10-year, \$1.34 billion contract with IBM in 2006 to automate eligibility determinations for food stamps, Medicaid and other welfare benefits and significantly reduce face-to-face meeting requirements via more computerized processes. However, a variety of problems with the rollout ultimately prompted former Gov. Mitch Daniels to cancel IBM's contract in 2009 and implement a "hybrid" 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.

IBM and the state sued each other for damages in the wake of the contract cancellation. A 2012 Marion County Superior Court ruling required the state to pay \$52 million to IBM 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.

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. The Supreme Court agreed to hear the case in August 2014.

Mediation sessions were set to begin in early 2015.

In other Indiana news:

- In October 2014, the Indiana Department of Administration issued a request for information seeking private sector interest in operating over 6,000 parking

spaces in two state-owned parking garages and surface parking lots in order to find a cost-effective way to create over 600 new spaces to replace those currently leased for state employees in private garages downtown. The *Indianapolis Business Journal* reported in November that the agency hoped to turn over parking operations to a private partner in early 2015—though no decision had been made at press time—and that six potential bidders attended an October pre-bid conference.⁶⁵

- The *Indianapolis Star* reported in January 2015 that the state’s Bureau of Motor Vehicles planned to end its contract with a company that employed maximum-security state prisoners to produce license plates, instead opting to shift production to a new vendor, Intellectual Technology Inc., in a contract estimated to save the state \$14 million over five years.⁶⁶

Kentucky

In late December 2014, Kentucky Gov. Steve Beshear and U.S. Rep. Hal Rogers announced a new public-private partnership with Macquarie Capital to develop a privately financed, state-owned broadband fiber infrastructure to expand high-speed Internet connectivity statewide. Under the deal, estimated to cost between \$250 million to \$350 million, Macquarie Capital and a team of specialists 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.

“If we were to rely solely on state government funding to get this project off the ground, it would take years, if not decades. Those kinds of tax dollars just aren’t available,” Gov. Beshear said in a press release. “In this technology-dependent economy, we can’t afford to wait another minute. That’s why this partnership is so valuable—it ramps up this project to the speed of the private sector without any additional burden on our taxpayers.”

In other news, Kentucky’s Tourism, Arts and Heritage Cabinet issued a request for proposals in November 2014 seeking a developer-operator to construct and operate a lodge at General Burnside Island State Park in Pulaski County. The developer would have the option of including a restaurant, convention facility and swimming pool, as well as potentially taking over management of the park’s golf course. In the request for

proposals, the state noted that it would consider a 50-year lease term, with three 10-year extensions, and the project may be eligible for a tax rebate through the state's Tourism Development Finance Authority, covering up to 50% of the investment amount over a 10-year period.⁶⁷ "We're optimistic that a developer could make this a major attraction in the Lake Cumberland region," Gov. Beshear said in a press release. Proposals were due in March 2015.

Louisiana

Now in the final year of his second term in office, Louisiana Gov. Bobby Jindal has remained a state leader on privatization throughout his tenure. An October 2014 review by *The Advocate* found that since Jindal took office in 2008, the state workforce has declined from 93,500 to approximately 62,000—or roughly one-third—in large part due to a wide range of privatization initiatives covered in previous editions of Reason Foundation's *Annual Privatization Report*.⁶⁸ According to the Jindal administration, many of the state employees affected by privatization were offered positions with the private service providers taking over the state functions.⁶⁹

An update on Louisiana privatization news from 2014 and early 2015 follows:

- In December 2014, the Louisiana Department of Health and Hospitals (DHH) received final approval from the U.S. Centers for Medicare and Medicaid Services (CMS) of the Jindal administration's privatization of six hospitals formerly operated by Louisiana State University as part of the state-run charity hospital system. The privatization initiative—covering nine of the 10 state-run hospitals and developed by Gov. Bobby Jindal's administration as a way to shed costs in response to a decline in federal Medicaid funding for the state—began in 2013 and continued through 2014, despite not having received final federal approval for all of the individual hospital deals.

The federal approval came with a catch, however. CMS disallowed advanced lease payments made by the state's private partners for the leases of six of the public hospitals privatized, requiring the state to reimburse the federal government \$190 million to recover the federal match portion of those lease payments. DHH is appealing the disallowance, maintaining that the advanced lease payments were not used as match to draw down federal funds, and the appeal process is expected to drag out for five to seven years.

The federal approval came after several of the hospital leases were reworked throughout 2014 in the wake of CMS's initial rejection of the state's

privatization deals earlier in May. Overall, the Jindal administration was pleased with the approval, despite the rejection of the advance lease payments. “The partnership hospitals are revolutionizing health care around the state, and now they’ll be able to continue their work to reduce patient wait times, expand access to quality care and train the doctors of tomorrow right here in Louisiana,” Gov. Jindal said in a December 2014 press release. The Administration touted a number of achievements thus far, including increased access to primary, specialty, emergency and urgent care; reduced prescription wait times; new specialty care clinics; increased screenings and more.

- For the second year in a row, legislation sponsored by State Rep. Kenny Havard modeled after Massachusetts’s Pacheco Law—widely regarded as the most onerous anti-privatization law in the nation—passed unanimously in the House only to be rejected by the Senate Finance Committee. House Bill 128 was designed to prohibit state agencies from entering into many privatization contracts without prior legislative review and approval—significantly increasing political risks to potential bidders and politicizing what are traditionally decisions made at the discretion of executive agencies—as well as subject routine contracting decisions to onerous pre-procurement and contract review processes, including a required analysis assuming the hypothetical costs of public employees continuing to provide the service “in the most cost-efficient manner” (presumably to facilitate required cost comparisons with bids received from private firms). A similar bill introduced by Havard in 2013 also passed the House unanimously and then stalled in the Senate committee.
- In June 2014, Gov. Jindal vetoed House Bill 142, that would have required all discretionary state professional, personal and consulting service contracts over \$40,000 in value to be approved by the Joint Legislative Committee on the Budget, and for those contracts not approved, the savings would have been deposited into a new higher education financing fund. The bill passed the House and Senate unanimously before being vetoed; Gov Jindal stated that the legislation would have created an “arbitrary and burdensome process” that “would make contracting with the state difficult” in his veto message. The sponsor, State Rep. Dee Richard, plans to reintroduce the legislation in the 2015 legislative session.⁷⁰
- An audit released by the Louisiana Legislative Auditor in June 2014 found that a major 2010 privatization of claims processing and loss prevention services in the state’s Office of Risk Management has saved \$16 million in the first three years of the contract, representing over 70% of the \$22 million in savings promised

over the five-year contract term. State officials expect to exceed the projected savings, according to the Associated Press.⁷¹

- A December 2014 report issued by the Louisiana Legislative Auditor’s office raised concerns that state health care spending has been rising at an accelerated clip despite the state’s 2012 Medicaid privatization, which aimed to lower costs by shifting approximately two-thirds of the state’s Medicaid recipients to a privately run managed care system. Annual Medicaid spending has risen by over \$900 million since 2012, according to the report, though auditors cautioned that their analysis was limited in scope and not sufficient to cast a judgment about the cost-savings performance of the privatization initiative itself.⁷² A report issued earlier in the year by the Louisiana Department of Health and Hospitals estimated that the privatization program was yielding savings of \$29.55 per member, per month relative to the previous state-run Medicaid program.⁷³ The Legislative Auditor’s Office later called those findings into question, claiming the department had made errors and used inconsistent data, which agency officials dispute.⁷⁴

Massachusetts

In January 2015, Massachusetts officials announced plans to expand their public-private partnership with AAA to provide vehicle license and registration renewal services to an additional six locations and add additional services for AAA customers. The expansion will double the number of locations AAA customers can receive registry services from six to 12 across the state and will now allow for commercial renewals, registration amendments/transfers, and duplicate titles, in addition to the current batch of service options (license renewals, duplicate licenses or ID cards, passenger vehicle registration). “Essentially doubling the Registry transactions offered and doubling the locations greatly increases our reach to our thousands of mutual customers,” Massachusetts Department of Transportation Acting Secretary and CEO Frank DePaola said in a press release.

Missouri

In the 2014 legislative session, the Missouri House of Representatives considered legislation to enable the use of public-private partnerships for the private financing and development of “social infrastructure”—such as higher education facilities, schools, public health facilities and other public buildings—by state and local governments.

House Bill 2053, sponsored by Rep. Paul Curtman, was modeled on Virginia's Public-Private Education Facilities and Infrastructure Act of 2002, the oldest and most widely used state social infrastructure PPP law.

The Missouri legislation would have created a legal framework to use PPPs to develop new K-12 and higher education facilities, recreational facilities, solid waste management facilities, technology and telecommunications infrastructure, and any other facility operated or used by a state or local public entity. The legislation would have also created a new Partnership for Public Facilities and Infrastructure Advisory Commission to advise state agencies, commissions, boards or other public institutions on proposals received under the PPP program.

HB 2053 passed out of the House Downsizing State Government Committee and the House Rules Committee but failed to receive a floor vote before the end of the 2014 session. However, Curtman re-introduced similar legislation (House Bill 206) in the 2015 legislative session; at press time, the bill had passed the House Committee on Government Efficiency but had not yet been considered on the House floor.

North Carolina

The role for privatization in a comprehensive reform of North Carolina's Medicaid program is likely to return to the legislative forefront after the Senate, House and administration of Gov. Pat McCrory failed to reach a consensus approach in 2014.⁷⁵ 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.⁷⁶ 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.⁷⁷

New Jersey

In August 2014, Gov. Chris Christie vetoed Senate Bill 770, legislation that would have placed significant roadblocks in front of future state-level privatization efforts. An updated version of a bill vetoed by Christie in 2013, the bill would have imposed a

range of restrictions on any proposed privatization contract totaling \$250,000 or more, including:

- a five-year limit on state privatization contracts;
- requirements that the public not be subject to any fees, fares or other charges greater than those currently charged; and
- requirements that wages and employee benefits for each contracted position not be less than those for comparable agency employees (making it virtually impossible to lower labor costs).

“By proposing additional red tape into an already time-consuming process, and erecting further barriers to privatization, this bill will adversely impact New Jersey’s already overburdened taxpayers,” Gov. Christie explained in his veto statement. “I will not support this thinly veiled effort to stymie privatization efforts under the guise of transparency.”

In other Garden State news, for the second time in three years, the New Jersey Turnpike Authority (NJTA) used the prospect of potential privatization to garner significant salary concessions from unions representing cash toll collectors, supervisors and management. In late 2013, the NJTA issued requests for proposals to potentially privatize electronic and cash toll collection on the New Jersey Turnpike and Garden State Parkway in 2016 to lower operating costs. After delaying the bid deadline several times throughout 2014, the Authority announced in November that it had reached a deal with unions representing cash toll collectors that will see significant salary cuts in exchange for job security through 2019. A similar privatization threat prompted voluntary salary reductions back in 2011.

New Jersey/New York State

A December 2014 report issued by the Port Authority of New York and New Jersey recommended ending overnight service on the PATH commuter rail transit system—which connects several New Jersey cities with Manhattan—and potentially privatizing its operation or turning it over to another public entity. The report, developed by a panel appointed by New York Gov. Andrew Cuomo and New Jersey Gov. Chris Christie, sought to find ways to lower the system’s costs—PATH is losing \$300 million per year, according to officials.⁷⁸ Both governors subsequently endorsed the plan, though Port Authority officials stressed that its recommendations were preliminary at this point.⁷⁹

Pennsylvania

In March 2014, the Pennsylvania Department of Transportation (PennDOT) reached financial close on the state's Rapid Bridge Replacement Project, a public-private partnership to reconstruct 558 structurally deficient bridges statewide. Under the partnership, Plenary Walsh Keystone Partners—a consortium that includes the Plenary Group, The Walsh Group, Granite Construction Company, and HDR Engineering (along with 11 Pennsylvania-based subcontractors)—will finance the \$899 million project in an availability-payment concession and will manage the bridges' design, construction and maintenance under one comprehensive contract to streamline project delivery. All 558 bridges will be replaced within three years of the 2015 project start date, and the consortium will maintain each bridge for 25 years after completion. PennDOT estimates the average per-bridge cost under this project to be \$1.6 million, compared to an average of more than \$2 million under a traditional delivery approach. Construction is expected to begin in the summer of 2015.

Separately, PennDOT issued a request for qualifications in November 2014 seeking a private partner to design, build, finance, operate and maintain compressed natural gas (CNG) fueling stations at 37 public transit facilities around the state. 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. “This project will ensure we can capitalize on this resource and also benefit the authorities that provide vital transportation services.” In January 2015, the agency shortlisted four teams that will be invited to submit proposals; the teams are led by Clean Energy, GP Strategies, Spire and Trillium CNG. PennDOT plans to issue a final RFP in the spring of 2015 and could make an award in late summer or early fall.

In early September, PennDOT officials also announced the agency's first sponsorship effort, a three-year contract with insurance company State Farm to sponsor the agency's roving safety patrol, which offers free motorist assistance on expressways in the Lehigh Valley, Harrisburg, Philadelphia and Pittsburgh regions. The sponsorship will offset nearly 11% of the state's \$4 million annual cost to operate the service.

The bridge replacement, CNG fueling station and safety patrol sponsorship projects were all facilitated by the state's passage of the Public and Private Partnerships for Transportation Act (Act 88) in 2012, enabling legislation authorizing PennDOT and other state agencies, transportation authorities and commissions to partner with private firms to finance, design, build, operate and/or maintain transportation-related projects.

In other Pennsylvania news, in early February 2015, new Pennsylvania Governor Tom Wolf signed Executive Order 2015-04 establishing a Governor's Office of Transformation, Innovation, Management and Efficiency, which calls for agency heads to solicit employee input and identify key staff to form innovation teams, enhances interagency coordination, and emphasizes public-private partnerships in order to find an immediate \$150 million in cost savings to help close the Commonwealth's current \$2.3 billion budget deficit. In addition to seeking internal cost savings ideas from employees, the new office will explore new opportunities to partner with the private sector and better leverage the state's collective buying and purchasing power.

South Carolina

The state of South Carolina currently owns 7,815 buildings and 2,526 pieces of land, according to an inventory of state real property released in July 2014. The long-delayed comprehensive inventory of state-owned land and buildings—the result of an executive order signed by Gov. Nikki Haley in October 2013—was finally released after years of agency non-compliance with a state law requiring them to produce annual real property inventories.⁸⁰ Haley told WSPA.com that the next step is an evaluation of consolidation and divestiture opportunities: “We need to look and see how much of that we need to get rid of. How much of that can we consolidate? What do we have that the taxpayers are paying for that's not even being used?”⁸¹

Texas

Shortly upon taking office in January 2015, new Texas Gov. Greg Abbott issued a memorandum endorsing contracting reform legislation—Senate Bill 353, sponsored by Sen. Jane Nelson—aimed at improving transparency and accountability in the contracting process. 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.”⁸²

In other Texas news, the Texas Department of State Health Services announced in October 2014 that it had selected Correct Care Solutions as the winning bidder for a contract to take over operation of the state-run Terrell State Hospital, a psychiatric hospital in northeast Texas that came under federal and state scrutiny in 2012 after the death of a 62-year old patient who was held in restraints for 55 straight hours, an incident that spurred the privatization initiative. Though the contract was originally slated to begin in January 2015, implementation was delayed by a request from State Sen. Robert Nichols to have the Texas State Auditor’s Office review whether the state’s Health and Human Services Commission (HHSC)—which oversees the health department—properly followed the procurement process and whether the privatization is authorized under state law.⁸³ In March, HSSC ultimately cancelled the procurement after the State Auditor’s Office issued a report finding that the HHSC and the Department of State Health Services did not fully comply with the HHSC’s contract planning and procurement processes.⁸⁴

The audit came on the heels of heavy public scrutiny over two controversial contracts undertaken by HHSC in recent years, contracts that also helped prompt the 2015 contracting reform legislation. A December 2014 audit by the State Auditor’s Office found that the agency has overseen major cost overruns and has inadequately monitored the performance of a telecommunications contract with AT&T that has jumped in size from \$1 million to over \$100 million since 2007.⁸⁵ And earlier in the month, HHSC cancelled a separate, no-bid contract with technology firm 21CT for Medicaid fraud investigation services after media outlets raised concerns regarding potential impropriety in the contract award and a rapid inflation in contract value from \$20 million to \$110 million.⁸⁶

Utah

Over the course of 2013 and 2014, Utah’s Free Market Protection and Privatization Board released the state’s first commercial activities inventory—a classification of all state agency activities as either “commercial” or “inherently governmental” in nature—and subsequent updates as part of a process that is required every two years under state law.⁸⁷

The inventory assessed 624 services across 25 state agencies and found that 431 services, or 69.1%, could be classified as inherently governmental in nature. A total of 193 services, or 30.9%, could be classified as commercial in nature. Of those commercial services, 167 services were found to have some inherently governmental aspects, while 26 were purely commercial in nature. The inventory found that 78 services, or 12.5%, of agency services were currently privatized.

The highest levels of privatization are occurring in the Department of Veterans Affairs (where 100% of the agency's major outreach, nursing home and cemetery services are privatized), the Department of Human Services (where 18 out of 26 major services, or 69%, are privatized) and the Department of Transportation (where 16 out of 24 major services, or 67%, are privatized).

The inventory also found that despite having 27 of its 43 major services identified as being commercial in nature, only five services are currently privatized in the Department of Administrative Services. Further, the inventory noted that 75% of the services provided by the Department of Alcoholic Beverage Control—consisting of retail operations, warehousing and distribution, and purchasing services—are commercial in nature and have not been privatized, despite a Board recommendation to do so.

In other 2014 news, the Board launched a contract with Sequoia Consulting to design a comprehensive privatization review process, as well as develop an accounting system to evaluate the fully loaded costs of government service provision to enable apples-to-apples comparisons with private sector bids, as called for in state law. At press time, work on these products was ongoing.

Further, in January 2015 the Board issued a report detailing its assessment of whether the Utah State Office of Education (USOE) unfairly competes with private vendors of student information systems used by local education agencies to manage student data, a review prompted by a petition filed by the Relational Data Corporation.⁸⁸ The Board found that USOE does compete unfairly in the student information system market in its development, marketing and operation of its Aspire student information system—which is used by over half of the school districts and charter schools in the state—and the Board further found that privatization of Aspire is feasible, potentially through the sale of the code and intellectual rights, licensing of the code to software companies while retaining intellectual rights, or some form of managed competition with Aspire personnel forming a company or a separate internal service fund that could operate on a competitive and transparent basis.

Last, the Board developed an outline for a property damage subrogation pilot project to outsource state property damage claims. The objectives of the pilot project are to increase the percentage and amount of third party damages recovered for state and local agencies, position the state and its political subdivisions to effectively and efficiently collect third party damages in the future, obtain insight on negotiating future cooperative contracts and service level agreements for recovery services, and outsource a service readily provided in the private sector. The pilot project would require some

statutory amendments relative to cost collection and fee structures, which the Board recommended pursuing in the 2015 legislative session.

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—has been introduced in the 2015 legislative session.

The legislation would amend the 2011 law requiring the state’s Office of Financial Management to identify six central service functions performed by DES 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 2015 version strips 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.

At press time, the bill had passed the House Committee on State Government but had not yet been heard in the House Committee on Appropriations.

Wisconsin

In June 2014, the Wisconsin Department of Administration presented the State of Wisconsin Building Commission with a list of state assets that could potentially be sold or leased, fulfilling a statutory requirement in a state budget bill signed by Wisconsin Gov. Scott Walker in June 2013. The inventory of assets for potential sale or lease consisted of:

- Underutilized acreage at the Hill Farms State Transportation Building (Madison)
- T-Hanger at Dane County Regional Airport (Madison)
- Telecommunications towers and related infrastructure (various locations statewide)
- Northern Wisconsin Center (Chippewa Falls)
- Underutilized acreage at the Southern Wisconsin Center (Union Grove)
- Ethan Allen School (Wales)
- Badger Road State Office Building (Madison)
- Knapp House (Madison)
- Wiscraft Workshop & Administration Buildings (Milwaukee)
- Heating & Cooling Plant fleet (various locations statewide)

The Department also announced that it had engaged several independent consultants to assist the state in evaluating the feasibility, market potential, risks and impacts of selling or leasing state assets; the list includes Public Financial Management, Robert W. Baird & Co., William Blair and Company, Loop Capital Markets, J.P. Morgan Securities and Latham & Watkins LLP.

The 2013 legislation requiring the inventory included provisions granting the governor's office the authority to sell state buildings and real property assets and use the proceeds to reduce the state's \$8 billion debt. Under the law, any asset sale or lease deal would have to receive prior approval by the state legislature's Joint Finance Committee and the State of Wisconsin Building Commission.

Later in the year, the Department of Administration took some initial action on one of the listed properties, issuing a request for proposals in October 2014 seeking a developer to build a new \$196 million, 600,000 gross square foot office building at the Hills Farms site in Madison to provide office space for seven state agencies. The developer would also construct a new parking structure and surface lots at the site, and it would purchase the remaining underutilized land and an existing Wisconsin Department of Transportation office building at that 21-acre site, as well as purchase a separate state office building that would be vacated as a result of the initiative.⁸⁹ In February 2015, the Department issued a notice of intent to award a contract to a joint venture between developers C.D. Smith and Gilbane Inc., subject to negotiation and final state approval.

In other Badger State news, the *Milwaukee Journal Sentinel* reported in April 2014 that Wisconsin's joint legislative audit committee had directed the state's Legislative Audit Bureau to undertake a comprehensive audit of the state's non-emergency medical transportation program, which was privatized in 2011.⁹⁰ The audit was prompted by complaints over poor service provided by current contractor MTM, which provides rides for low-income and elderly Medicaid recipients to get to health care appointments. Earlier in the year, the state's Department of Health Services warned the firm about its performance, threatened fines, and placed it under a corrective action plan, and by June the agency found that the company was meeting its performance standards, specifically with regard to rides denied (due to vehicles not being available) and the average speed to answer calls.⁹¹

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