

HB

545

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: 1
 Bill Version: HB 545
 () Publish Date: 3/25/2004

Revision Date/Time (Note if correction): _____ Dept. Affected: Administration
 Title A bill relating to the State Procurement Code RDU Leases
lease and contract extensions... Component Leases
 Sponsor Rules
 Requester Governor Component No. 81

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Various in all state agencies						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2004) cost: 0.0
 Mark this box (X) if funding for this bill is included in the Governor's FY 2005 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill would provide lease and contract extensions for real property up to a maximum extension of 10 years if a minimum cost saving of at least ten percent below market rates on the rent due under the lease are achieved. No additional funds will be necessary as a result of this bill.

Prepared by: Vern Jones, Chief Procurement Officer Phone 465-5684
 Division General Services Date/Time 4/21/04 9:05 AM
 Approved by: Kevin Jardell, Deputy Commissioner Date 4/21/2004
 Agency Administration

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HB 545

March 24, 2004

The Honorable Pete Kott
Speaker of the House
Alaska State Legislature
State Capitol, Room 208
Juneau, AK 99801-1182

Dear Speaker Kott:

Under the authority of article III, section 18 of the Alaska Constitution, I am transmitting a bill relating to the extension of terms for leases and terms for contracts for goods and services under the State Procurement Code.

This bill would make several changes to the State Procurement Code. Section one of the bill would authorize the state to negotiate lease rate reductions on existing leases in exchange for certain term extensions when favorable lease rates are available. The current process only authorizes lease extensions if the property owner agrees to either (1) reduce the lease rate by ten percent and perform modifications to bring the property into Americans with Disabilities Act compliance, or (2) reduce the lease rate by 15 percent. The problem is, the current process does not take into account whether the current lease rate is already below market. Due to market conditions and current lease rates, this high discount is often not acceptable to property owners.

Many of our current lease rates are already below market and leave the lessor unwilling to meet the 10 or 15 percent reduction to extend the lease. In fact, only a small percentage of lease extensions have been negotiated under the existing provisions. The only option left for the state is to issue a new request for proposals. Often this results in additional moving costs and market rates, which can represent a substantial increase in costs to the state.

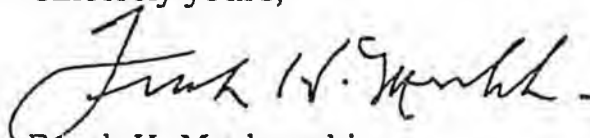
The method proposed in this bill would ensure that the state receives the best value for its leasing dollars. Lease extensions would only be authorized where the rates are a minimum of five percent below market. This would allow the state to maintain its presence in leases which are already well below market rates. Additional savings beyond the five percent would be negotiated depending on a number of factors such as location, current market value, existing vacancies, and market trends.

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The bill also would authorize term extensions for up to five years for contracts for goods and services provided a minimum cost savings of at least five percent could be achieved on the price of the goods or services as set in the current contract. Under present law, at the end of the contract term, contracts for goods or services must be resolicited through a competitive process or a new contract awarded based upon alternative procurement methods regardless of price reductions that may be offered by the contractor if the contract were extended.

I urge your prompt and favorable action on this measure.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Frank H. Murkowski".

Frank H. Murkowski
Governor

Enclosure

Memorandum

Department of Administration
Office of the Commissioner

To: Representative Tom Anderson
Attention: Josh Applebee

Date: April 13, 2003

From: Kevin Jardell
Assistant Commissioner
Department of Administration

Phone: 465-2200

Subject: Lease Negotiations

Lease extensions under the current law (AS 36.30.083) require a minimum 15% discount from the current lease rate. DOA's proposed change would require a minimum 5% discount from a market rate.

In the past, DOA leases consisted of a constant rental rate throughout the life of the lease. This was unduly costly for the state, since initial construction and tenant improvements (TI) of office buildings are generally financed and amortized only over the initial lease period, not the optional renewal periods. The state was effectively paying multiple times for one-time costs.

Several years ago, DOA changed this practice by requiring lessors to identify up front construction and TI costs from ongoing rental rates and bid them separately. This generally results in declining costs in the option periods, because the rates for option periods no longer include amortized construction and TI costs. A net present value calculation is applied to ensure the state considers the time value of money when awarding leases.

Given this change, we can not expect to gain significant savings in the future under AS 36.30.083. For example:

A lease could be established at a market rate of \$2.20/sf (Class A, downtown Anchorage) for the initial 9 year period of a lease, dropping to \$0.98/sf for each of the two, five year renewal periods. It would be impossible to negotiate a 15% reduction to a lease rate of \$0.98/sf when the market rate for the space is \$2.20/sf.

As more and more older leases are replaced by those with the new cost model, the requirement of a minimum reduction of 15% below the current lease rate will effectively prevent us from achieving any negotiated savings.

KJ/aw