

Department of Legislative Services
 Maryland General Assembly
 2021 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 182 (Senator Ellis)
 Education, Health, and Environmental Affairs
 and Budget and Taxation

**State Finance – General Obligation Debt – Application of Minority Business
 Participation Goals**

This bill makes all projects that receive funding from the capital budget subject to the State’s minority business enterprise (MBE) goal established in State law. **The bill takes effect July 1, 2021.**

Fiscal Summary

State Effect: General fund expenditures increase by \$81,940 in FY 2022 and \$232,500 in FY 2023 to enforce the bill’s requirements. Out-year expenditures reflect ongoing costs. Depending on the interpretation of the bill’s requirement, additional staff and expenditures may be necessary, as discussed below. No effect on revenues.

(in dollars)	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	81,900	232,500	228,800	236,700	244,900
Net Effect	(\$81,900)	(\$232,500)	(\$228,800)	(\$236,700)	(\$244,900)

Note: () = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: Local capital projects that receive State capital grants must comply with the State’s MBE requirements; it is assumed that local governments can comply with the requirements with existing resources. Some local governments have their own MBE preference programs. Revenues are not affected.

Small Business Effect: Meaningful.

Analysis

Current Law: For a description of the State's MBE program, please see the **Appendix – Minority Business Enterprise Program**. The 29% MBE participation goal currently in effect is a statewide goal; it is not designed or intended to serve as a goal for each agency or for individual contracts. Rather, State procurement statute and regulations establish a process by which procurement staff and MBE liaisons in each agency establish contract goals for each contract, which are based on the goods or services being purchased and the availability of MBEs in the marketplace that can provide those goods or services. In many cases, those contract goals are substantially less than the 29% statewide goal (and some are higher).

Capital Grants

The capital budget bill sets forth the amount of State debt to be created and details the amount to be allocated to specific purposes for each proposed capital project. With the support of a legislative sponsor, any applicant may request funding from the capital budget for a capital project. In order to be eligible for a capital grant from the General Assembly, a project must:

- be capital in nature;
- have a useful life of at least 15 years;
- serve a public purpose; and
- not be for religious purposes.

Applicants are generally required to provide matching funds for the capital grants, and projects must be completed within seven years.

State Expenditures: The bill has no effect on the State's capital projects as they are already generally subject to MBE requirements. However, the bill makes all recipients of capital grant funding from the State subject to the MBE participation goal. The capital budget typically takes effect June 1 of each year, but Counsel to the General Assembly advises that the Office of the State Treasurer does not release capital grant funds until July 1, the beginning of the fiscal year (and the bill's effective date). Therefore, this analysis assumes that the bill applies to all grants awarded in the fiscal 2022 capital budget.

The Capital Grants and Loan Division within the Department of General Services (DGS) oversees and monitors approximately 1,400 active recipients of capital grants from the State. Each project is required to undergo a compliance review process to ensure its compliance with the program's current requirements as established by the Board of Public Works. Between 200 and 300 new projects are typically authorized each year.

MBE compliance is typically monitored by contract management staff in agencies that sponsor each project. In the case of capital grant recipients, it is assumed that DGS assumes the oversight role with respect to compliance with the bill’s MBE requirement. With the addition of at least 200 projects each year, DGS requires additional staff to ensure compliance with the MBE requirement. This analysis assumes that one additional compliance officer is required in the first year and two additional officers are required beginning in the second year as the number of grantees increases (generally, new grantees are added at a faster pace than existing projects are completed).

Therefore, general fund expenditures increase by \$81,943 in fiscal 2022, which assumes no start-up delay from the bill’s July 1, 2021 effective date because the Treasurer begins disbursing grants on that day; expenditures further increase by \$232,545 in fiscal 2023. This estimate reflects the cost of hiring one compliance officer in fiscal 2022 and two more compliance officers in fiscal 2023 to monitor and enforce grantees’ compliance with the bill’s MBE requirement. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

	<u>FY 2022</u>	<u>FY 2023</u>
New Positions	1.0	2.0
Salaries and Fringe Benefits	\$74,323	\$212,900
Operating Expenses	<u>7,620</u>	<u>19,645</u>
Total DGS Expenditures	\$81,943	\$232,545

Future year expenditures reflect annual increases and employee turnover and ongoing operating expenses.

It is not clear whether the bill applies the 29% MBE participation goal to each grant recipient, or whether it expects grantees to establish a customized MBE participation goal for each project using the same process used by State agencies. As the bill states that the projects are “subject to the minority business participation percentage goal established” in statute, it is assumed that the bill is requiring each project to meet the 29% participation goal, and that DGS does not need to go through the individual contract goal setting process for each grantee. To the extent that the bill is interpreted differently, DGS may require two additional staff to complete the MBE goal setting process for each project, but those staff are not reflected in this analysis.

Small Business Effect: Minority-owned small businesses in the construction sector benefit from the application of the MBE requirement to more construction projects.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

Information Source(s): Governor's Office of Small, Minority, and Women Business Affairs; Department of General Services; Board of Public Works; Department of Legislative Services

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Appendix – Minority Business Enterprise Program

The State’s Minority Business Enterprise (MBE) program requires that a statewide goal for MBE contract participation be established biennially through the regulatory process under the Administrative Procedure Act. The biennial statewide MBE goal is established by the Special Secretary for the Governor’s Office of Small, Minority, and Women Business Affairs (GOSBA), in consultation with the Secretary of Transportation and the Attorney General. In a year in which there is a delay in establishing the overall goal, the previous year’s goal applies. The Special Secretary is also required to establish biennial guidelines for State procurement units to consider in deciding whether to establish subgoals for different minority groups recognized in statute. In a year in which there is a delay in issuing the guidelines, the previous year’s guidelines apply.

In August 2013, GOSBA announced a new statewide goal of 29% MBE participation that applied to fiscal 2014 and 2015; as no new goal has been established, the 29% goal remains in effect for fiscal 2021. GOSBA issued subgoal guidelines in July 2011 and then updated them effective August 2020, as summarized in **Exhibit 1**. The guidelines state that subgoals may be used only when the overall MBE goal for a contract is greater than or equal to the sum of all recommended subgoals for the appropriate industry, plus two. In June 2014, new regulations took effect allowing MBE prime contractors to count their own work for up to 50% of a contract’s MBE goal and up to 100% of any contract subgoal. Previously, certified MBE prime contractors could not count their own participation toward any goal or subgoal on an individual contract, but their participation was counted toward the State’s MBE goal.

Exhibit 1 Subgoal Guidelines for Minority Business Enterprise Participation

	<u>Construction</u>	<u>Architectural/ Engineering</u>	<u>Maintenance</u>	<u>Information Technology</u>	<u>Services</u>	<u>Supplies/ Equipment</u>
African American	8%	7%	9%	10%	-	6%
Hispanic	-	-	3%	-	2%	2%
Asian	-	-	2%	-	3%	-
Women	11%	10%	-	10%	10%	8%
Total	19%	17%	14%	20%	15%	16%
Total +2	21%	19%	16%	22%	17%	18%

Source: Governor’s Office of Small, Minority, and Women Business Affairs

There are no penalties for agencies that fail to reach the statewide target. Instead, agencies are required to use race-neutral strategies to encourage greater MBE participation in State procurements.

History and Rationale of the Minority Business Enterprise Program

In 1989, the U.S. Supreme Court held in the *City of Richmond v. J.A. Croson Co.* that state or local MBE programs using race-based classifications are subject to strict scrutiny under the equal protection clause of the Fourteenth Amendment to the U.S. Constitution. In addition, the ruling held that an MBE program must demonstrate clear evidence that the program is narrowly tailored to address actual disparities in the marketplace for the jurisdiction that operates the program. As a result, prior to each reauthorization of the State's MBE program, the State conducts a disparity study to determine whether there is continued evidence that MBEs are underutilized in State contracting.

The most recent disparity study was completed in 2017 and serves as the basis for the most recent reauthorization of the MBE program. It found continued and ongoing disparities in the overall annual wages, business earnings, and rates of business formation between nonminority males and minorities and women in Maryland. For instance, average annual wages for African Americans (both men and women) were 37% lower than for comparable nonminority males; average annual wages for nonminority women were 33% lower than for comparable nonminority males. It also found continued disparities in the use of MBEs by the State compared to their availability in the marketplace to perform work in designated categories of work. For instance, African American-owned construction businesses were paid 5.1% of State construction contract dollars, but they made up 10.3% of the construction sector in the relevant State marketplace. Nonminority women-owned construction businesses were paid 7.5% of State construction contract dollars but made up 13.7% of the construction sector. According to the analysis, these differences were large and statistically significant.

The MBE program is scheduled to terminate July 1, 2022; it has been reauthorized eight times since 1990, the latest by Chapter 340 of 2017. **Exhibit 2** provides MBE participation rates for major Executive Branch agencies based on contract awards made during fiscal 2019, the most recent year for which data is available.

Exhibit 2
Minority Business Enterprise Participation Rates, by Agency
Fiscal 2019

<u>Cabinet Agency</u>	<u>% Participation</u>
Aging	1.4%
Agriculture	4.9%
Budget and Management	7.4%
Commerce	1.2%
Education	6.0%
Environment	28.6%
Executive Department	1.8%
General Services	15.0%
Health	14.6%
Higher Education Commission	3.0%
Housing and Community Development	38.4%
Human Services	14.7%
Information Technology	15.4%
Juvenile Services	19.5%
Labor	26.1
Military	7.0%
Natural Resources	NA ¹
Planning	4.6%
State Police	15.0%
Public Safety and Correctional Services	17.5%
Transportation – Aviation Administration	27.2%
Transportation – Motor Vehicle Administration	16.0%
Transportation – Office of the Secretary	18.5%
Transportation – Port Administration	18.5%
Transportation – State Highway Administration	20.3%
Transportation – Transit Administration	15.1%
Transportation – Transportation Authority	11.6%
Statewide Total²	17.9%

¹ Data not provided.

² Includes the University System of Maryland, Morgan State University, St. Mary’s College of Maryland, and non-Cabinet agencies.

Source: Governor’s Office of Small, Minority, and Women Business Affairs

Requirements for Minority Business Enterprise Certification

An MBE is a legal entity, other than a joint venture, that is:

- organized to engage in commercial transactions;
- at least 51% owned and controlled by one or more individuals who are socially and economically disadvantaged; and
- managed by, and the daily business operations of which are controlled by, one or more of the socially and economically disadvantaged individuals who own it.

A socially and economically disadvantaged individual is defined as a citizen or legal U.S. resident who is African American, Native American, Asian, Hispanic, physically or mentally disabled, a woman, or otherwise found by the State's MBE certification agency to be socially and economically disadvantaged. An MBE owned by a woman who is also a member of an ethnic or racial minority group is certified as either owned by a woman or owned by a racial or ethnic minority but not both. The Maryland Department of Transportation is the State's MBE certification agency.

A socially disadvantaged individual is someone who has been subject to racial or ethnic prejudice or cultural bias within American society because of his or her membership in a group and without regard to individual qualities. An economically disadvantaged individual is someone who is socially disadvantaged whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities compared with those who are not socially disadvantaged. An individual with a personal net worth in excess of \$1.5 million, adjusted annually for inflation, is not considered economically disadvantaged. The inflation-adjusted limit for calendar 2021 is \$1,788,677.