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Joint Committee on Finance

Paper #161

Authority to Sell Other State Properties (Administration and Building Commission)

[LFB 2013-15 Budget Summary: Page 40, #6 (Part) Page 83, #8 (Part)]

CURRENT LAW

The Department of Administration (DOA) may offer for sale state-owned property when it determines the sale is in the best interest of the state. The sale may occur on the basis of either public bids or a negotiated price and could occur with or without the approval of the agency with jurisdiction over the property. The Building Commission must approve any such sale. DOA is prohibited from selling any property under the jurisdiction of the UW System Board of Regents and property held at the Northern Center for Developmentally Disabled by the Department of Health Services (DHS). DOA is also prohibited from selling other specific state properties. Finally, DOA is not authorized to close or sell any facility or institution that is required to be operated by state law.

The Building Commission currently has authority to sell or lease any part of a state owned building, structure, or land, including farmland. The Commission may also transfer state-owned property among state agencies. The Commission does not have authority to sell state-owned property under the jurisdiction of the UW System Board of Regents or any other agency that has specific authority to sell or lease property under their jurisdiction. Further, the Commission does not have explicit authority to sell any property of an agency with or without the approval of the agency. Finally, the Commission does not have authority to sell any property of an agency after DOA has notified the Commission in writing that an offer for sale of that property is pending.

The Commission can sell state-owned property that has been declared surplus, in that it is unused and not needed for the agency's operations or included in the agency's plan for construction or development. The Commission must obtain Joint Finance Committee approval for the sale of any surplus property with a value in excess of \$20,000. The Commission also has authority to lease space in state office buildings for commercial use, including retail, service and office uses.

GOVERNOR

Provide DOA and the Building Commission similar authority related to the sale or lease of state-owned real property, and the use of the proceeds from the sale or lease of such property. Specify that both DOA and the Commission could sell or lease any state-owned real property, except for specific exemptions, whether or not the property or facility is in use or the agency is required by law to operate the facility. Authorize DOA or the Commission to sell or lease of state-owned real property under the jurisdiction of the UW System Board of Regents or property held by DHS at the Northern Center.

Specify DOA could only sell property if the sale is approved by the Building Commission, but would not be required to obtain Commission approval for the lease of any state facility. Authorize the Building Commission to lease state-owned real property with or without the approval of the agency. Specify that the Building Commission could not sell or lease any property after being notified by DOA that an offer for sale or a lease agreement is pending on that property.

Beginning on January 1, 2014, require each agency to biennially submit to DOA an inventory of real property under its jurisdiction together with an estimated fair market value of each property. Require that the agency specifically identify any under-utilized assets in the inventory. Specify that no later than July 1 following the receipt of the inventories, DOA would be required to obtain appraisals of all properties in the inventories that are identified by the Department for potential sale. DOA would be required to submit to the Building Commission, an inventory containing the location, description, and fair market value of each parcel of property identified for potential sale. These provisions would replace the surplus land inventory requirements, which would be deleted under the bill.

DISCUSSION POINTS

1. This paper deals with the issue and concerns related only to the sale of state facilities other than heating, cooling, and power plants. This office has prepared three other papers on the Governor's recommendations pertaining to the sale or lease of state facilities: Paper #160 relating to the sale of state heating, cooling, and power plants; Paper #162 relating to the use of proceeds from the sale of state properties; Paper #163 relating to the DOA Secretary's authority to modify the authorized positions and budgets of agencies whose property is sold or leased.

DOA Errata

2. The DOA Secretary, in an errata letter to the Committee Co-chairs on April 23, 2013, indicated that bill should be amended to clarify the intent of the following provisions:

a. provide DOA the authority to lease state-owned property, without the approval of the agency with jurisdiction over the property. The bill would allow DOA to sell such property without agency approval, and DOA indicates that it was the Governor's intent to extend similar authority to potential leases of state property;

b. specify that DOA's or the Building Commission's authority relating to the sale or lease of state properties would not apply to real estate portfolio transactions related to investments of the Employee Trust Fund (ETF) made by the State of Wisconsin Investment Board (SWIB); and

c. specify that the UW Board of Regents would be required to submit a biennial inventory of all real property under its jurisdiction to DOA that specifically identifies any underutilized assets, but would not be required to include the estimated fair market value of each property.

Previous Authority Relating to State Property Sales

3. While the authority being requested for the DOA Secretary and the Building Commission is substantially broader than past legislative enactments of similar authority, the current proposal relating to the sale of state facilities is not the first time the state has placed an emphasis on selling state properties. Under 2005 Act 25, DOA was authorized to sell any state-owned real property, with certain exceptions, if the Department determined that the sale is in the best interest of the state. The sales were subject to Building Commission approval. DOA could place properties on the inventory of properties to be sold with or without the agency approval.

4. Unlike the Governor's recommendations, the Act 25 authority did not extend to UW System properties. The UW System Board of Regents was provided separate authority to sell UW properties. It also did not allow the DOA Secretary to close any facility whose operation is required by law. The authority to sell state properties lasted for only two years under Act 25, but was later extended through subsequent biennia by 2007 Act 20 (through 2007-09) and 2009 Act 28 (through 2009-11). Act 25 assumed that \$36 million would be deposited to the state's general fund in the 2005-07 biennium and 2007 Act 20 assumed that \$40 million would be deposited to the state's general fund in the 2007-09 biennium. 2009 Act 28 did not assume any revenues associated with the extension of the authority. In total, property sold under the Act 25, Act 20, and Act 28 provisions totaled \$9.4 million.

5. Prior to Act 25, state land or real property sales had typically been carried out under prior state law governing the sale of surplus lands. Surplus lands are defined as land under the jurisdiction of the Building Commission and allocated for use by an agency, but unused and not needed for the agency's operations or included in the agency's plan for construction or development. For surplus properties surplus having a fair market value of at least \$20,000, the Commission would have to get Joint Finance Committee approval under the 14-day passive review process. Net proceeds for any sale were deposited to the budget stabilization fund. The following table lists the sale of surplus land amounts deposited to the budget stabilization fund since 2003-04.

State Surplus Land Sales

<u>Fiscal Year</u>	<u>Surplus Land Sales</u>
2003-04	\$27,400
2004-05	471,800
2005-06	115,500
2006-07	79,800
2007-08	292,100
2008-09	164,200
2009-10	212,800
2010-11	117,100
2011-12	<u>141,200</u>
Total	\$1,621,900

Current Proposal

6. Staff from DOA indicate that the authority provided to the Secretary of DOA is intentionally broad, because at this point DOA does not have a thorough inventory of the properties the state owns. DOA has yet to identify which properties may make financial sense to sell, and of that group, which properties are marketable. As a result, the Governor did not want to limit the authority to sell or lease state-owned property to specific types of property or to property of specific agencies until an inventory of such property is compiled, and those properties that are in the best interest of the state to sell or lease are identified. Given this uncertainty, no funds associated with the sale of those properties are included in the Governor's 2013-15 budget.

7. The bill would require each state agency to biennially submit to DOA an inventory of real property under its jurisdiction together with an estimated fair market value of each property. Under the DOA errata, the UW-System Board of Regents would also be required to complete the inventory. Agencies would have to specifically identify any under-utilized assets in the inventory and no later than July 1 following the receipt of the inventories, DOA would be required to obtain appraisals of all properties in the inventories that are identified by the Department for potential sale. DOA would be required to submit to the Building Commission, an inventory containing the location, description, and fair market value of each parcel of property identified for potential sale. If the Committee adopts the administration's requested correction to exclude SWIB/ETF managed properties from the sale provision, it may also wish to exclude those properties from the inventory requirement.

8. Properties owned by the state generally fall into the following general categories: (a) those used to house state agency staff; or (b) those used to provide some service to a specific population. Those properties that provide a service to the public could include UW campus dormitory facilities, prisons and mental health facilities, and Department of Transportation (DOT) highways and waysides. State parks, beaches and other public properties owned by the Department of Natural Resources (DNR) also provide services to the public, but DOA or the Building

Commission could not sell these public properties held by DNR.

9. Under the bill, the DOA Secretary or the Building Commission could sell or lease a state building currently occupied by an agency. Subsequently, the Building Commission, under its current authority, could authorize that space be leased in order to provide space for agency staff that had been occupying that building. These lease costs would then be paid through the agency's future operating budget. When the state sells a property, a decision has to be made as to whether the state should consolidate those staff in an existing building, construct a new, more cost efficient building, or move the agency to leased space. DOA or the Building Commission could use the sale and lease authority if they determine that in certain instances it would be less costly for the state to sell outdated buildings and lease space rather than renovate the building or construct a new building. Also, due to rapid changes in information technology, as well as changes in architecture and office space layouts, in some cases the state may have less risk under a lease than if the state were to construct new space, or renovate old space, which may quickly become outdated. Under a lease scenario, the lessee assumes any risk associated with a space becoming outdated or obsolete while a state agency could move to a more updated space without having to make any capital outlays.

10. However, leasing space for state agency staff is not without risk for the state. The state can finance buildings and improvements at a lower cost than private sector developers due to the federal tax exemption on state bonds issued for capital improvements. In addition, state buildings are exempt from local property taxes unlike most privately held building. This reduces the annual holding costs associated with such buildings for the state compared to a private building, although the state does make some payments for municipal services to municipalities on these buildings. Presumably, private developers would pass on these higher building costs in the rents charged for space leased to state agencies, and factor in a profit margin. Further, by leasing space rather than owning the space, the state would not have a long-term asset, which could offset some of the outstanding debt associated with that space. Also, as land and buildings appreciate in value, the state would have a more valuable asset by owning the property. Conversely, under a lease arrangement, the state would likely pay higher lease costs due to any appreciation in the value of the building in which the space is leased.

11. Providing the authority to sell state properties, including those that house state agency staff, could seem to be contrary to the Building Commission's 2013-15 State Building Program recommendation for the construction of a new state office facility that would house DOT and ETF staff. The Commission recommended that a state-owned facility to house these agencies be constructed at a total cost of \$196.6 million.

12. DOA staff have indicated that no plans currently exist for the DOA Secretary to use the authority provided under the bill to sell state-owned properties that provide a public service like a campus dormitory, state highway, or state prison to a private entity. However, such sales could occur under the authority provided DOA and the Commission under the bill. If the state were to sell such properties, either the state or public users of that property would then have to purchase that service from a private entity. For example, if the DOA Secretary would use the authority under the bill to sell a prison or mental health unit to a private provider, the state would have to buy back the prison or mental health services from the private provider. Again, similar to the issues related to

housing a state agency, the question arises as to whether the state or a private service provider could provide the service at a lower rate.

13. Also, if the state were to sell a property that is being used to provide a public service and that service must continue to be provided, the state could lose some control over the quality and cost of service provided by the private entity. Such arrangements could be considered similar to a public-private partnership, whereby a private entity provides a public service and assumes the risks associated with providing that service in exchange for receiving the revenues generated from providing the service. Questions arise as to how the state would ensure that the service would continue to be provided in quality manner, whether the assets would maintained properly, and whether the state would have control over the fees that could be charged for the service.

Impact on Outstanding State Debt

14. Concerns exist about the level of state debt, and the amount of additional debt that would be authorized under the Governor and Building Commission's recommendations. DOA has indicated that the primary reason for the Governor's recommendation is so that the state could use the proceeds from the sale or lease of state property to retire state debt, specifically highway-related debt.

15. While the state may receive one-time funds from the sale of an asset that would be used to retire outstanding state debt, the state would essentially be trading that debt obligation for a similar type of obligation. The state would in effect be paying for the private purchaser's cost of capital through the lease payments made to provide space for a state agency. Similarly, if a state asset that provides a public service is sold, the public would be paying for the purchaser's cost of capital in the rates the purchaser charges for the public service provided from the purchased asset. For example, if a dormitory is sold to a private party, students would be paying for the purchaser's cost of the private capital through their dormitory fees. Therefore, while using the proceeds from the sale of an asset to retire state indebtedness could lessen the amount of outstanding debt on the state's financial statements, the state or public users of the asset that was sold would likely still be paying some or all of cost of private purchaser's debt associated with purchase of the capital asset.

16. The state's general obligation indebtedness has grown over the past five years from \$5.9 billion in 2008 to \$8.0 billion in 2012 (a 36.6% increase). However, some of this growth has been due to decisions over the past 10 years to restructure a portion of the state's debt and defer the repayment of principal. Also, past authorizations of higher levels of general obligation bonding to finance road construction has also led to higher debt levels. While the Governor's budget recommendations do not include any additional debt restructuring, the bill would provide an additional \$994.2 million for highway-related construction. If the level of general obligation debt is a concern, the Committee and the Legislature could give consideration to reducing the levels of debt being recommended under the Governor's and Building Commission's recommendations rather than attempting to reduce debt through the sale of existing state assets.

Alternatives to Governor's Proposal

17. Under the bill, the DOA Secretary could not sell any property without Building

Commission approval. However, the bill would provide the DOA Secretary authority to lease state-owned real property without Commission approval. If the Committee is concerned about the authority provided to DOA Secretary related to the leasing of state facilities, the Committee could also require Building Commission approval (Alternative A2a) of any DOA lease of state facilities.

18. Under the bill, current and future DOA secretaries and Building Commission members would be making the decisions that would have an impact on the overall facility costs of state government. By providing the broad authority to the DOA Secretary and the Building Commission, the Legislature would be forgoing any future ability to review these decisions and determine whether such sales or leases would be in the long-term best interest of the state.

19. Under the state building program requirements, any acquisition, construction or renovation of a state facility with a cost in excess of \$760,000 must be enumerated in statute. This enumeration requirement allows the Legislature to have oversight over the facilities the state is constructing or acquiring. However, the Governor's recommendations, by potentially allowing facilities, which were required to be approved by the Legislature in order to be built, to be sold or leased without legislative approval, would seemingly run counter to the policy of legislative approval associated with current law project enumeration requirements.

20. 2011 Special Session Bill 11 (enacted as 2011 Act 10), included provisions that allowed the DOA Secretary broad authority to sell or lease state utility plant facilities. Before being deleted at Conference Committee, the Joint Finance Committee modified the provision to provide some legislative oversight over any potential sale or lease. Specifically, the Committee specified that DOA could not sell, enter into a lease, or contract for any of the operations of a state-owned utility plant unless such a transaction was approved by the Joint Committee on Finance under a 14-day passive review process. In addition, the Committee required DOA to submit the following to the Committee as part of any request: (a) estimated value of the facility as determined by DOA and at least one qualified privately-owned assessor; (b) full cost of retiring remaining debt for the facility; (c) a cost benefit analysis that considers the short-term and long-term costs and benefits to the state for selling, leasing, or entering a contract for facility operations; (d) the length and conditions of any proposed sale, lease or service agreement between the state and a proposed purchaser; (e) the estimated budgetary impact for affected state agencies for at least the current and following biennium; and (f) any other information requested by the Committee.

21. If the Committee wanted to provide DOA and the Building Commission the authority, but were concerned by the lack of analysis and documentation currently before the Legislature, and the lack of legislative oversight provided under the bill, the Committee could put in place requirements similar to those the Committee adopted in 2011. The sale or lease could only occur after approval of Joint Finance Committee under the 14-day passive review process (Alternative A2b). Similar to its amendment to 2011 Act 10, the Committee could also require DOA to complete a cost benefit analysis and other analyses, and provide documentation on a potential sale or lease of state facility before the property could be sold or leased (Alternative A2c).

22. Given the magnitude of the authority that would be provided the DOA Secretary and the Building Commission, and the fact that no specific properties have been identified for sale or lease, the Committee could delete the Governor's recommendations at this time (Alternative A4).

The authority to sell or lease state properties could be provided at a later date when more is known about the possible properties to be sold or leased. DOA may not have a complete inventory and valuation of state facilities completed until the second year of the biennium. Therefore, the Committee could authorize agencies and DOA to conduct the inventory, and appraise the properties identified for sale. Then, at a later date, when it is known what DOA and the Building Commission may offer for sale or lease, the Legislature could provide the DOA Secretary and the Commission the authority to pursue the sale or lease of the properties listed on the report (Alternative A3a). This would provide the Legislature more oversight on the specific properties that DOA Secretary or the Commission intends to sell or lease. The alternative would require subsequent legislation before DOA or the Building Commission could sell or lease any state property.

23. In addition, if the Committee would like DOA to complete a thorough analysis of the long-term financial interests of the state associated with the sale or lease of state facility after the completion of the inventory of properties, the Committee could delete the authority provided DOA and the Building Commission under the bill. Alternatively, the Committee could direct DOA to complete the type of analysis identified by Committee during its 2011 Act 10 deliberations. This would require a significant level of analysis and documentation by DOA on any property identified for sale or lease before the Legislature would be asked to approve the sale or lease of the property (Alternative A3b). Under this alternative, subsequent legislation would be needed before DOA or the Building Commission could sell or lease a property

Sale or Lease of Certain Properties

24. In past legislation authorizing the sale of state properties, DOA was prohibited from selling property under the jurisdiction of the UW System Board of Regents. Instead, that legislation provided the UW System Board of Regents separate authority to sell properties under its jurisdiction. Proceeds from the sale of the properties were deposited to the UW System's general operations PR appropriation for the general operation of the UW System. According to Building Commission records, UW campuses have disposed of 15 properties since 2005 through property transfers or sales.

25. The UW System receives a significant amount of gifts and grants from individual donors and campus foundations. Some concern exists that providing the DOA Secretary and the Building Commission the authority to sell UW System assets could raise concerns among donors and could inhibit the ability of campuses to raise gift funds. Grant agreements are generally signed between the Board of Regents and the donor, or a campus foundation. Under the bill, a donor or a foundation could be reluctant to sign such grant agreements with the Board of Regents for a building or improvement, if the Board is not ultimately in control of that building and its potential sale. If the Committee is concerned about the impact the Governor's recommendations would have the UW System campuses ability to generate gifts and grants for campus facilities, the Committee could retain the current law prohibition by specifying that authority provided DOA and the Building Commission would not extend to the sale or lease UW System properties (Alternative B1).

26. Some state facilities were constructed with 100% federal funds or 100% gift funds. Others have been partially funded with federal monies or gift or grant funds. The bill would specify that the proceeds from the sale of these facilities would have to be used to meet any federal

obligation related to the federal funding. Also, DOA or the Building Commission would have to adhere to any restriction governing the use of proceeds if the property was constructed or acquired using gift or grant funds.

27. The state would not likely generate excess proceeds from 100% federally-funded or 100% gift-funded properties given the potential restriction on the use of proceeds from the sale of a property or facility constructed or acquired with those funds. Therefore, the sale or lease of such properties would not reduce the state's outstanding debt levels, which DOA has indicated is a primary reason for the authority provided the Secretary and the Building Commission under the bill. Given the potential concerns that could arise from the sale or lease of these facilities and the lack of proceeds that could be generated from their sale or lease, the Committee could specify that the provisions in the bill do not apply to state properties that are 100% funded from either federal funds or gift and grant funds (Alternative B2).

28. Conversely, the state is often responsible for costs of staffing, maintaining, heating, and cooling federal- and gift-funded properties. Under the bill, the state could sell or lease such facilities and potentially save on the direct costs of operation of those properties. However, if the property is surplus, it could be sold under the existing sale of surplus property statutes. If such properties are not surplus, and the state would have to lease back the property or a different space, the state would still be incurring some operations costs, as well as the purchaser's capital costs.

Competitive or Negotiated Sale or Lease

29. Under current law, the Building Commission is required to sell or lease state property on the basis of either public bids, or on the basis of negotiated prices. For any property sold by DOA, DOA is required sell the property based on public bids or negotiated prices. Under the bill, the Commission would no longer have to use a public bidding or a negotiated price process for leased property. However, under the bill, if either DOA or the Commission would carry out a negotiated price sale, it would have to be done through a competitive and transparent process. Further, DOA or the Commission would have the authority to reject any bid in the best interest of the state. DOA indicates that this authority is necessary because DOA may contract with a third party consultant to negotiate the transaction.

30. Given the expanded authority of DOA and the Building Commission to sell or lease properties, some concern has been raised that such sales or leases should be carried out using a competitive bid process. This would ensure that DOA or the Commission, in the case of a sale or lease, would at a minimum be required to attempt to obtain multiple bids on properties to be sold, or multiple request for proposal offers in the case of leases. Then, after the competitive bid or request for proposal process is carried out, if two or fewer competitive bids or proposals are received, DOA or the Commission could negotiate the sale or lease with one of those entities, under the competitive and transparent process required under bill (Alternative C2). If DOA needs to contract to buy back the services or output of the property sold, they could do so under their contracting and procurement authority.

ALTERNATIVES

A. Authority to Sell or Lease State Properties

1. Approve the Governor's recommendations, as modified by the DOA errata, to provide the DOA Secretary and the Building Commission the authority to sell or lease state properties other than heating, cooling, and power plants. In addition, specify the following: (a) provide DOA the authority to lease state-owned property, without the approval of the agency with jurisdiction over the property; (b) specify that DOA's or the Building Commission's authority relating to the sale or lease of state properties, and the related inventory requirement, would not apply to real estate portfolio transactions related to investments for the Employee Trust Fund made by the State of Wisconsin Investment Board; and (c) specify that the UW Board of Regents would be required to submit a biennial inventory of all real property under its jurisdiction to DOA that specifically identifies any underutilized assets, but would not be required to include the estimated fair market value of each property.

2. Modify the Governor's recommendation, as modified by the DOA errata, by specifying one or more of the following:

a. require Building Commission approval of any state property leased by the DOA (the Governor's recommendations only require Commission's approval when DOA is proposing to sell a state property).

b. that DOA or the Building Commission could not sell, enter into a lease, or contract for any of the operations of a state-owned property unless such a transaction was approved by the Joint Committee on Finance under a 14-day passive review process.

c. require DOA to submit the following to the Committee as part of any request for approval on a sale or lease: (a) the estimated value of the facility as determined by DOA and at least one qualified privately-owned assessor; (b) the full cost of retiring remaining debt for the facility; (c) a cost benefit analysis that considers the short-term and long-term costs and benefits to the state for selling, leasing, or entering a contract for facility operations; (d) the length and conditions of any proposed sale, lease or service agreement between the state and a proposed purchaser; (e) the estimated budgetary impact for affected state agencies for at least the current and following biennium; and (f) any other information requested by the Committee.

3. Delete the Governor's recommendation. Instead, do one or both of the following:

a. beginning on January 1, 2014, require state agencies and the UW System Board of Regents to biennially submit to DOA an inventory of real property under its jurisdiction. Require that the agency and Board of Regents specifically identify any under-utilized assets in the inventory. Specify that no later than July 1 following the receipt of the inventories, DOA would be required to obtain appraisals of all properties in the inventories that are identified by the Department for potential sale. DOA would be required to submit to the Building Commission, an inventory containing the location, description, and fair market value of each parcel of property identified for potential sale. These provisions would replace the surplus land inventory requirements, which

would be deleted under the bill. (Subsequent legislation would be needed before DOA or the Building Commission could sell or lease these state properties).

b. require DOA to complete the following on any properties identified for potential sale: (a) the estimated value of the facility as determined by DOA and at least one qualified privately-owned assessor; (b) the full cost of retiring remaining debt for the facility; (c) a cost benefit analysis that considers the short-term and long-term costs and benefits to the state for selling, leasing, or entering a contract for facility operations; (d) the length and conditions of any proposed sale, lease or service agreement between the state and a proposed purchaser; and (e) the estimated budgetary impact for affected state agencies for the current and subsequent biennium. (Subsequent legislation would be needed before DOA or the Building Commission could sell or lease these state properties).

4. Delete provision.

B. Authority to Sell or Lease Certain Properties

Adopt one or both of the following:

1. Prohibit DOA or the Building Commission from offering for sale or lease any property, other than a heating, cooling, or power plant, that is under the jurisdiction of the UW System Board of Regents.

2. Prohibit DOA or the Building Commission from selling any state-owned property that is 100% funded from federal funds or from gifts or grants.

C. Competitive or Negotiated Sale or Lease

1. Approve the Governor's recommendation that any sale of state property would have to be completed under a competitive bid or on the basis of a negotiated price as determined through a competitive and transparent process. Specify as part of the competitive bid process, DOA or the Commission would have the authority to reject any bid in the best interest of the state.

2. Modify the Governor's recommendation to specify that if DOA or the Building Commission would sell or lease any state properties under the authority provided under the bill, DOA or the Commission could only do so under a competitive bid, or competitive request for proposal process. However, if after the competitive bid or proposal process, two or fewer competitive bids are received, specify that DOA or the Commission could negotiate a sale or lease using a competitive and transparent process. As under AB 40, specify as part of the competitive bid process, DOA or the Commission would have the authority to reject any bid in the best interest of the state.

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