

Department of Legislative Services
2014 Session

FISCAL AND POLICY NOTE
Revised

House Bill 727

(Delegate Olszewski, *et al.*)

Economic Matters

Finance

Procurement - Prevailing Wage - Applicability

This bill lowers the share of total school construction project costs that must be paid by the State for the prevailing wage to apply from 50% to 25%, thereby expanding its application.

The bill takes effect July 1, 2014, and applies only to a procurement contract executed on or after that date.

Fiscal Summary

State Effect: No effect on total State funding for school construction, which is established annually in the State’s capital budget. The Department of Labor, Licensing, and Regulation (DLLR) can enforce the bill with existing budgeted resources.

Local Effect: The local share of school construction costs may increase by between 2% and 5% in 10 counties that will have to pay prevailing wages under the bill for their school construction projects. Given the inconsistency and inconclusiveness of the empirical research, however, actual effects may vary by project, and in some cases they may be negligible. Local revenues may increase slightly from liquidated damages collected under the bill. **This bill may impose a mandate on a unit of local government.**

Small Business Effect: Minimal. Any increase in school construction costs is typically passed on by the construction company to the local school system.

Analysis

Current Law: “Public works” are structures or works, including a bridge, building, ditch, road, alley, waterwork, or sewage disposal plant, that are constructed for public use or

benefit or paid for entirely or in part by public money. Contractors working on eligible public works projects in Maryland must pay their employees the prevailing wage rate. Eligible public works projects are those carried out by:

- the State; or
- a political subdivision, agency, person, or entity for which at least 50% of the project cost is paid for by State funds.

Any public works contract valued at less than \$500,000 is not required to pay prevailing wages. The State prevailing wage rate also does not apply to any part of a public works contract funded with federal funds for which the contractor must pay the prevailing wage rate determined by the federal government.

Prevailing wages are wages paid to at least 50% of workers in a given locality who perform the same or similar work on projects that resemble the proposed public works project. If fewer than 50% of workers in a job category earn the same wage, the prevailing wage is the rate paid to at least 40% of those workers. If fewer than 40% receive the same wage rate, the prevailing wage is calculated using a weighted average of local pay rates. The State Commissioner of Labor and Industry is responsible for determining prevailing wages for each public works project and job category.

The commissioner has the authority to enforce contractors' compliance with the prevailing wage law. Contractors found to have violated the prevailing wage law must pay restitution to the employees and liquidated damages to the public body in the amount of \$20 a day for each laborer who is paid less than the prevailing wage. If an employer fails to comply with an order by the commissioner to pay restitution, either the commissioner or an employee may sue the employer to recover the difference between the prevailing wage and paid wage. The court may order the employer to pay double or triple damages if it finds that the employer withheld wages or fringe benefits willfully and knowingly or with deliberate ignorance or reckless disregard for the law.

The Governor must include at least \$385,000 in the budget each year for the Prevailing Wage Unit within DLLR.

The University System of Maryland, Morgan State University, St. Mary's College of Maryland, and the Maryland Stadium Authority are all exempt from the prevailing wage law.

The State pays at least 50% of *eligible* school construction costs in all counties, as shown in **Exhibit 1**. Costs that are ineligible for State funding include, among other things, planning and design fees and movable objects or equipment (*e.g.*, furniture or bookshelves). Since total construction costs are higher than eligible construction costs, the State often pays less than 50% of total school construction costs in eight counties that

receive a 50% State match of eligible costs. In addition, some school construction projects in Carroll and Calvert counties, with State shares of 58% and 56%, respectively, also receive less than 50% of *total* project costs from the State, depending on the distribution of eligible and ineligible costs.

Exhibit 1
State Share of Eligible School Construction Costs
Fiscal 2012-2015

County	FY 2012	FY 2013	FY 2014	FY 2015
Allegany	91%	93%	93%	93%
Anne Arundel	50%	50%	50%	50%
Baltimore City	94%	93%	93%	93%
Baltimore	50%	50%	50%	50%
Calvert	61%	56%	56%	56%
Caroline	86%	81%	78%	78%
Carroll	61%	58%	58%	58%
Cecil	75%	70%	69%	69%
Charles	77%	72%	67%	63%
Dorchester	71%	69%	69%	69%
Frederick	72%	67%	62%	60%
Garrett	59%	54%	50%	50%
Harford	59%	63%	63%	63%
Howard	61%	60%	60%	60%
Kent	50%	50%	50%	50%
Montgomery	50%	50%	50%	50%
Prince George's	73%	68%	63%	62%
Queen Anne's	55%	50%	50%	50%
St. Mary's	75%	70%	65%	64%
Somerset	88%	83%	82%	82%
Talbot	50%	50%	50%	50%
Washington	73%	71%	71%	71%
Wicomico	87%	96%	96%	96%
Worcester	50%	50%	50%	50%

Source: Public School Construction Program

Chapter 402 of 2013 established the Task Force to Study the Applicability of the Maryland Prevailing Wage Law. The task force has completed its work, but a final report has not been issued. The task force elected not to make any recommendations with respect to the applicability of the prevailing wage law.

Background: The federal Davis-Bacon Act, originally enacted in 1931, requires contractors working on federal public works contracts valued at more than \$2,000 to pay their employees the prevailing local wage for their labor class, as determined by the U.S. Secretary of Labor. The general intent of the law, and similar state and local laws, is to stabilize local wage rates by preventing unfair bidding practices and wage competition. Thirty-two states and the District of Columbia currently have prevailing wage laws; since 1979, nine states have repealed their prevailing wage laws.

Maryland adopted a prevailing wage law in 1945 (Chapter 999), but it only applied to road projects in Allegany, Garrett, and Washington counties. In 1969, the statute was amended to include State public works contracts of \$500,000 or more. There have been periodic changes to the law and the definition of “prevailing wage.” In 1983, the law was broadened to include public works projects in which the State funds 50% or more of the total project costs and 75% or more in the case of public schools. Chapter 208 of 2000 reduced the prevailing wage threshold for public schools from 75% to 50% of construction costs, thereby bringing school construction projects in line with prevailing wage requirements for other public works projects.

The number and value of prevailing wage projects has risen dramatically in just two years. DLLR advises that its prevailing wage unit currently monitors more than 700 projects, compared with 187 in fiscal 2011 and 446 in fiscal 2012. The total value of those projects has also increased, from \$3.1 billion in fiscal 2011 to almost \$6.0 billion currently, which includes projects procured by local governments. In fiscal 2013, the unit investigated 625 project sites for prevailing wage compliance, recovered \$287,000 in unpaid wages on behalf of laborers, and collected \$86,000 in liquidated damages on behalf of the State and local governments. It has averaged three prevailing wage inspectors annually.

Five Maryland jurisdictions – Allegany, Charles, Montgomery, and Prince George’s counties and Baltimore City – have local prevailing wage laws requiring public works projects in the jurisdiction to pay prevailing wages; Montgomery County’s prevailing wage ordinance does not apply to school construction projects.

State Fiscal Effect: The bill requires virtually all school construction contracts valued at more than \$500,000 to pay prevailing wages, which increases the number of projects that have to pay prevailing wages and are, therefore, subject to prevailing wage monitoring and enforcement by DLLR.

The Public School Construction Program (PSCP) reviewed school construction projects contracted during fiscal 2012 through 2014 (429 total projects) and estimates that, had this bill been in effect during that period, 131 additional projects would have been required to pay prevailing wages that otherwise did not have to under current law. This represents an average of about 43 projects per year; the Department of Legislative

Services (DLS) notes that the annual level of school construction funding from the State for the three years covered by the PSCP analysis was well above the average for the last 10 years, and it exceeds the level budgeted and/or forecast for fiscal 2015 through 2019. Therefore, DLS estimates that, on average, the bill results in between 30 and 50 additional school construction projects each year being required to pay prevailing wages.

Although the number of prevailing wage projects monitored by DLLR has increased tremendously in the last three years without any commensurate increase in enforcement staff, the Governor's proposed fiscal 2015 budget for the Prevailing Wage Unit includes four additional regular positions for the unit dedicated to enforcement. After action by the Senate and the House Appropriations Committee, three new positions remain. Given that the current caseload for a wage and hour investigator exceeds 200 projects, DLS believes that the unit can absorb 30 to 50 additional projects each year with the budgeted staffing level.

Local Fiscal Effect: As noted above, counties with a 50% State match for school construction generally do not have to pay prevailing wages. For fiscal 2015, these eight counties are Anne Arundel, Baltimore, Garrett, Kent, Montgomery, Queen Anne's, Talbot, and Worcester counties. In addition, with a State share of 56% and 58% respectively, some projects in Calvert and Carroll counties may also not qualify for prevailing wages under current law, depending on the distribution of eligible and ineligible costs. By lowering the State funding threshold, however, the bill makes school construction contracts in as many as 10 counties fall under the prevailing wage statute if their value meets or exceeds \$500,000.

Contract Costs: For this bill and recent prior versions of this and other prevailing wage bills, DLS conducted an extensive review of research on the effect of prevailing wage laws on the cost of public works contracts and found inconsistent results. The primary challenge confronted by all prevailing wage researchers is identifying an appropriate "control group" consisting of projects of similar type, timing, and location that do not pay the prevailing wage. In most jurisdictions that require a prevailing wage, all projects of a specified type and size are subject to it, so there is no natural control group. Some researchers have compared project costs in states or localities before and after they adopted prevailing wage requirements, but their findings are clouded by the difference in time, during which construction costs changed and other factors were not consistent. Therefore, research findings related to the effect of the prevailing wage on project costs are inconsistent and often inconclusive. A similar review of research conducted by DLLR for the Task Force to Study the Applicability of the Maryland Prevailing Wage Law also concluded that "data limitations create difficulty for researchers on both sides of the issue."

Early theoretical studies concluded that higher wages under prevailing wage contracts increase contract costs by between 10% and 30%, but many of those studies were flawed, and their findings could not be replicated. For instance, a frequently cited study of 18 projects by the U.S. General Accounting Office was found to have omitted from its analysis 12 projects in which the prevailing wage was actually lower than the market wage. Empirical studies carried out in the 1990s found much smaller contract cost effects, often in the range of between 2% and 10%, but those studies were hampered by the control group challenge identified above.

Recent empirical data from two counties yields similar results. Local school systems occasionally solicit side-by-side bids with and without prevailing wages to help them decide whether they want to accept the full State match (and, thus, be subject to the prevailing wage) or a lesser State match without being subject to the prevailing wage. Data submitted by Carroll County to the task force shows that the cost differential for six school construction solicitations since June 2011 ranged from 3.2% to 8.0%; for all side-by-side solicitations requested since 2007, the average cost differential was 7.2%. Frederick County reported to the task force that a side-by-side solicitation for North Frederick Elementary School had a cost differential of 13.8%.

These empirical findings have been countered over the past 10 years by studies that have found no statistically significant effect of prevailing wages on contract costs. Among the possible reasons cited in these studies for the absence of a cost effect include:

- higher wages are associated with higher productivity, reducing the overall cost of the project;
- contractors may be saving money in other areas, such as using lower-cost supplies and materials; and
- contractors may absorb some of the cost of paying higher prevailing wages in order to remain competitive in government procurement.

One area of the research in which there is a general consensus is that labor costs, including benefits and payroll taxes, represent between 20% and 30% of construction costs. Therefore, a 10% gap between prevailing wages and market wages would increase total contract costs by about 2.5%. That is consistent with the findings of some of the empirical studies that have been conducted, but as noted above, recent studies have failed to find an effect even of that size. Nevertheless, given the empirical evidence that prevailing wages tend to be higher than nonprevailing wages and that labor costs are a significant portion of overall project costs, DLS believes that it is reasonable to expect that the prevailing wage requirement adds between 2% and 5% to the cost of a public works project. Given the inconsistency and inconclusiveness of the empirical research, however, actual effects may vary by project, and in some cases they may be negligible.

Liquidated Damages: The 10 counties with projects that become subject to the prevailing wage statute under the bill also may receive liquidated damages collected by DLLR from contractors who violate the prevailing wage law. Given the small number of projects likely to be affected in any one jurisdiction, DLS expects local revenues from liquidated damages to be minimal.

Small Business Effect: Small businesses that receive State funds for public works projects valued at more than \$500,000 likely see total project costs increase by 2% to 5% due to the application of prevailing wages.

Additional Information

Prior Introductions: None.

Cross File: SB 232 (Senator Stone, *et al.*) - Finance.

Information Source(s): Department of Labor, Licensing, and Regulation; Carroll, Cecil, Charles, Frederick, Montgomery, and Queen Anne's counties; Public School Construction Program; Department of Legislative Services

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House Bill 727

Procurement – Prevailing Wage - Applicability

MACo Position: **OPPOSE**

To: Economic Matters Committee

Date: February 25, 2014

From: Andrea Mansfield

The Maryland Association of Counties (MACo) **OPPOSES** HB 727. This bill would impose prevailing wage requirements on local public works projects, increasing project costs and affecting the number of projects budgeted each year.

Currently, State prevailing wage laws apply only if at least 50% of the project costs are State-supported. HB 727 lowers this threshold to require prevailing wage rates to be paid for a local project receiving any amount of State funds. This could be as low as \$100.

This “one size fits all” approach would significantly undermine a local government’s ability to fund and manage its capital budget, especially those smaller in size and in more rural areas of the state. The Task Force to Study the Applicability of the Maryland Prevailing Wage Law has examined prevailing wage policies and has focused its discussions on school construction projects. Data shared with the Task Force suggests that school construction projects bid with prevailing wage have an average cost increase ranging from 3% to 30% depending on the type of project. The cost differential for a recent project bid in Frederick County was 13%. Local governments receive State support in varying amounts for a number of public works projects, including school construction, transportation, jails, and recreation facilities. Imposing a State-mandated cost increase on primarily locally funded projects reduces their affordability, and means fewer such projects can be supported.

Further, most local governments do not have the same overall presence in the marketplace to affect competitive wages, and with the weak economy and State cost shifts of recent years, many have significantly reduced their capital budgets. Placing new, overly broad prevailing wage mandates on local governments would further limit the number of projects funded each year by increasing project costs and limiting local flexibility.

This bill would also affect the State's ability to extend funding for school construction projects. As described in the Report of the Capital Debt Affordability Committee on

Recommended Debt Authorizations for Fiscal Year 2015, the escalation in building costs over the past ten years has hampered the State's efforts to bring all public schools up to minimum standards and school construction needs continue to exceed the anticipated level of State funding. Both the statutory debt limitations and the inability of the current state property tax rate to fund ongoing debt service make this restraint immediately relevant. Policies increasing the cost of capital projects cannot simply be "rolled into" a larger capital budget. Inevitably, project cost inflation means that more much-needed school projects will be denied funding altogether.

For these reasons, MACo **OPPOSES** HB 727 and urges the Committee to give the bill an **UNFAVORABLE** report.