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FISCAL IMPACT REPORT

ORIGINAL DATE 2/05/09

SPONSOR Asbill LAST UPDATED _____ HB _____

SHORT TITLE Subcontractor Bonding Requirement Exceptions SB 363

ANALYST Aguilar

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY09	FY10		
	NFI		

(Parenthesis () Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Public School Facilities Authority (PSFA)
 Public Education Department (PED)
 Regulation and Licensing Department (RLD)

SUMMARY

Synopsis of Bill

Senate Bill 363 provides for exceptions to the requirement for subcontractors to provide performance and payment bonds to general contractors on a public works project when performing work valued at \$125,000 or more under certain types of procurement methods: Design-build, Construction Manager At-Risk (CMAR) and Competitive Sealed Proposals.

FISCAL IMPLICATIONS

PSFA estimates that the provisions contained in this bill will impact approximately 50 percent of all school construction projects in FY 2009 and FY 2010.

Increased costs to projects vary depending on the amount of work to be provided by subcontractors and the capabilities and capacity of the general contractor. Examination of 122 projects involving major renovation and new construction of public schools throughout NM totaling \$692.4 million, since the effective date of the subcontractor bonding requirement, reveals a total expenditure of approximately \$6.9 million (1.00 percent of total contract) directly attributable to subcontractor bonding, in addition to \$5.2 million (0.75 percent of total contract)

for bonding costs to the general contractor. It is unknown by PSFA what the total direct cost to all state and local government capital projects is for sub-contractor bonding but, it appears that the same ratios are likely to apply.

According to PSFA, the total direct and indirect cost of the subcontractor bonding requirement is difficult to estimate, since it is not known how many contractors have not been able to bid public works projects due to inability to obtain bonding, and the impact a reduced number of bidders may have had on the cost competitiveness of public works bids. Limited competition, especially in the rural areas, appears to have contributed significantly to the huge escalations in average square footage costs since bonding of subcontractors became mandatory in June, 2005, as a result of the enactment of Laws 2005, Chapter 99 (SB814). Further, in a 2008 survey of greater than 28,000 contractors and subcontractors in New Mexico, survey respondents listed subcontractor bonding as one of the most significant barriers to bidding public works, and as one of the primary reasons that many contractors either choose or are unable to bid public works projects.

As these three forms of construction procurement are relatively new or have not been utilized for many school projects to date, it is not known as to the potential savings by not requiring subcontractor bonding.

SIGNIFICANT ISSUES

PSFA reports that in 2007 the minimum contract amount for subcontractor bonding was raised from \$50,000 to \$125,000 in lieu of a total repeal. This has caused the overall percentage of subcontractor bonding to total bonding to decline from 60 percent to 57.5 percent since enactment.

Design-build, Construction Manager At-Risk (CMAR) and Competitive Sealed Proposals do not involve the traditional “low bid” form of procurement of construction as each allow the “construction team” put together by the general contractor to be evaluated and selected based on their qualifications, capabilities, and experience through a request for proposals in lieu of a bid. As the general contractor has the option to utilize subcontractors with whom they are familiar or have had a positive working relationship working with in the past, there should be a significant reduction in risk of default.

Bonding of subcontractors is in addition to the bonds provided by the general contractor as required by 13-4-1 8, known as the "Little Miller Act", which also requires, on all construction contracts awarded in excess of \$25,000, for the primary contractor to provide a performance bond and a labor and material payment bond each equal to 100 percent of the awarded bid amount.

These bonds are primarily intended to protect payment of all workers, subcontractors and material suppliers by providing a remedy for recovery of monies due for wages, performing work or providing materials on a state or local construction project. The owner and taxpayers are also protected as a mechanism to guarantee delivery of the contracted work should the awarded contractor fail to perform. These provisions apply to all state and local public works projects, including school construction. Public works projects are defined in the procurement code as projects that require professional services of architectural or engineering services costing \$50,000 or more; or landscape architectural or surveyors costing \$10,000 or more, excluding gross receipts tax.

It was argued that by adding the requirement of bonding of subcontractors, the owner would benefit through proportional reductions in the general contractor bond costs passed on to the owner through lower risk of subcontractor default. Instead, general contractor bond costs remain at essentially the same rate as they were before subcontractor bonding was enacted, and the cost of subcontractor bonding exceeds the cost of general contractor bonding, which provided all risk reduction to the owner, labor and vendors. The addition of subcontractor bonding appears to have contributed to disproportionate increases in construction costs in NM as compared to other states, and has profoundly limited the number of subcontractors able to perform work on projects. This has been especially problematic in rural areas—please see both references cited earlier under “fiscal implications.”

It has become increasingly difficult to obtain bids on public works projects. By exempting these specific types of procurement from the requirement, it would remain the general contractor's option to require a bond from a subcontractor which would increase the pool of available subcontractors, and should bring down the cost of construction, especially in rural communities. Between 2005 and 2007 costs for rural school construction in NM increased as much as 85 percent, while construction in urban areas rose approximately 30 percent. These figures when compared to other states which saw approximately 20 percent increases in construction costs over the same period would tend to indicate other factors are affecting NM construction prices beyond the higher material and fuel costs that have been universally experienced.' One of the most likely “factors” may be the additional costs to subcontractors that relate to subcontractor bonding, costs which would be passed on to owners.

Although recent bids have revealed a more favorable square foot cost for school construction due to the downturn in the economy and reduction in fuel prices, there has also been a reduction in revenues to fund schools which have severely impacted the State's ability to meet the \$3.6 billion in school construction needs. The economy has also made it difficult for local school districts to pass bond issues to provide the statutorily required matches toward projects awarded by the Public School Capital Outlay Council (PSCOC) through the standards-based process.

ALTERNATIVES

Pre-qualification of contractors and grading of performance by public owners on a statewide basis by a regulatory agency such as CID or the DOL would more appropriately provide the protection of general contractors from subcontractor default when performing public works projects, and would also increase the quality of work for owners. Construction trade organizations, as well as the companies providing bonding, need to become more involved in developing strategies that would reduce the risk of subcontractor default, as well as increase the quality of work performed.

PA/svb