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FISCAL IMPACT REPORT

SPONSOR Vigil DATE TYPED 3/5/05 HB 857

SHORT TITLE Procurement Code Subcontractor Bonding SB _____

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APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY05	FY06	FY05	FY06		
			See Narrative		

SOURCES OF INFORMATION

LFC Files

Responses Received From

Energy, Minerals and Natural Resources Department (EMNRD)
 Department of Finance and Administration (DFA)
 Public Education Department (PED)
 Construction Industries Division (CID)
 Public School Facilities Authority (PSFA)

SUMMARY

Synopsis of Bill

House Bill 857 adds a new section to the State Procurement Code requiring subcontractors to provide a performance and payment bond on a public works building project if the subcontractor's contract for work to be performed on the contract is fifty thousand dollars (\$50,000) or more.

Significant Issues

Public works projects are defined in the procurement code as projects that require professional services of architectural or engineering services; or landscape architectural or surveyor services.

The PSFA reports the provisions of the "Little Miller Act" require all construction contracts awarded in excess of \$25 thousand to include a performance bond and payment bond each equal to 100% of the awarded bid amount. The bonds are intended to protect subcontractors and material suppliers by providing a remedy for recovery of monies due on a construction project. The

owners are also protected to guarantee the delivery of the contracted work should the awarded contractor fail to perform.

PSFA further reports that the Subcontractors Fair Practices Act currently requires each subcontractor submitting a bid to a contractor to submit a payment and performance bond if so requested by the contractor. This section also allows the expense to be the responsibility of the subcontractor if the contractor in his written request for subcontract bids states the amount and requirements of the bonds. The provisions of this bill will only make this mandatory.

DFA believe the bill provides a remedy for general contractors if a subcontractor fails to perform in compliance with the conditions of a contract or fails to pay for materials or labor. It is not uncommon for a subcontractor to go bankrupt. If this should occur, a general contractor still must meet the performance requirements included in its contract with the public entity.

If a subcontractor is required to purchase a performance and payment bond, the general contractor may be able to collect damages from the bonding company. Bonding companies will not enter into a bonding arrangement with high risk subcontractors, thus lowering the risk to a general contractor that the project may have delays.

PERFORMANCE IMPLICATIONS

DFA reports HB 857 provides no additional performance or payment protection for the State since the State already has the ability to collect any damages from the bonding company. Ultimately, however, the State may benefit from the possible elimination of higher risk subcontractors from public works construction projects.

FISCAL IMPLICATIONS

The costs of bonds are reported at approximately 1.5% and are typically passed on to the agency as part of the costs of construction. The State pays the full cost of the performance and payment bonds purchased by the general contractor. It is unclear how much of the cost of a similar subcontractor bond purchase would be passed on to the State.

Unless the State benefits from the employment of lower risk subcontractors, there would be no incentive to pay any additional bonding cost, since the State is already protected by the general contractor performance and payment bond. If the purchase of a subcontractor performance and payment bond would improve the bond rating of the general contractor, the State might actually incur lower bonding costs on behalf of the general contractor.

The PSFA believe these provisions may limit competition and increase the cost of construction for public works contracts significantly. The bill as written makes subcontractor bonding mandatory on top of bonding required of the general contractor. Limiting the number of subcontractors that are able to work on projects may be especially problematic on small rural projects.

ADMINISTRATIVE IMPLICATIONS

According to the CID of the RLD, it is not uncommon for subcontractors to be undercapitalized. Agencies may incur additional bid prices due to increased operational overhead being applied to bidders.

A reduction in the number of qualified bidder applicants may cause delays in the awarding and completion of public works projects.

Individual agencies will have to determine how to enforce the provisions of this bill. The State should hold the general contractor liable for completing the project according to the agreed upon terms.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Duplicates SB 814

TECHNICAL ISSUES

HB 857 creates ambiguity as to whether the general contractor's or subcontractor's performance bond is primary. It is also unclear whether the subcontractor would issue the performance bond to the agency or general contractor. Bonding companies may also challenge which performance bond should be called upon.

EMNRD notes that obtaining bonds from subcontractors may be difficult since there is no contractual relationship between the using agency and the subcontractor. The subcontractor's contractual agreement is with the general contractor. The general contractor's contractual agreement is with the owner/agency.

The PSFA notes that specific requirements for payment and performance bonds on construction are not found in the "procurement code", but rather under Public Works Contracts.

OTHER SUBSTANTIVE ISSUES

General contractors believe this bill may cause subcontractors on agency funded projects to be more reliable and financially responsible. General contractors report they figure a contingency in the bid submitted to cover projects when a subcontractor fails to perform. If a general contractor knew ahead of time that a subcontractor could bond a project, it may allow for a reduction in bid amount and projects completed in a more timely fashion.

ALTERNATIVES

Existing policy will remain in place requiring contractors to provide a bond for public works contracts.

The State could make a provision within the invitation to bid requiring the general contractor to use only subcontractors that can procure a performance and payment bond on hazardous or particularly difficult projects. This could be done on an individual basis.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL?

New Mexico general contractors will continue to assume the risk of subcontractors failing to perform as a normal part of doing business.