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FISCAL IMPACT REPORT

ORIGINAL DATE 1/27/07
 LAST UPDATED 2/9/07 HB _____

SPONSOR SPAC

SHORT TITLE Relating to Public Works SB 227/SPACS

ANALYST Kehoe

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY07	FY08		
	NFI		(See Fiscal Implications)

(Parenthesis () Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files

SUMMARY

Synopsis of Bill

The Senate Public Affairs Committee Substitute for Senate Bill 227 raises the minimum contract amount for which a subcontractor is required to provide a bond from \$50,000 to \$125,000.

FISCAL IMPLICATIONS

Enacted for the first time in 2005, Chapter 99 requires subcontractors to be bonded for work to be performed on a project with a value of \$50,000 or more. There is no evidence that additional performance or payment protection is realized by the public owners, including schools and government entities, through the enactment and requirements of the Subcontractors Bonding Act. The owner was already covered by 100% payment and performance bonds of the general contractor which already allowed collection of any damages due to default.

Since the effective date of the subcontractor bonding requirement, examination of 36 projects (see attached) involving major renovation and new construction of public schools throughout New Mexico totaling \$222.7 million reveals a total expenditure of approximately \$2.4 million (1.09%) directly attributable to subcontractor bonding in addition to \$1.6 million (.73%) for bonding costs of the general contractor. It is not known if increasing the bond requirement for work performed from \$50,000 to \$125,000 for subcontractor's work will reduce the price of

public works projects. The cost is generally about 1 to 1 ½ percent of the value of subcontractor work.

It has been argued that requiring bonding of subcontractors would benefit the owner through proportional reductions in the general contractor bond costs passed on to the owner through lower risk of subcontractor default. However, based on actual project- and cost-tracking for public school construction, it appears that the requirement has contributed to disproportionate increases in construction costs in New Mexico as compared to other states and has had a profound effect on the number of subcontractors able to perform work on projects. This has been especially problematic in rural areas.

As it has become increasingly difficult to obtain bids on public works projects, it is unknown if this bill would increase or decrease the pool of available contractors and subcontractors to bring down the cost of construction, especially in rural communities areas near and around the borders of the state. Costs for school construction in rural areas in New Mexico have increased as much as 85% over the last year and a half, while construction in urban areas has risen by approximately 30%. These figures when compared to other regional states which have seen approximately 20% increases in construction costs over the same period would tend to indicate that some other factors are affecting New Mexico construction prices beyond the higher material and fuel costs that have been universally experienced.

SIGNIFICANT ISSUES

Effective June 17, 2005, Laws of 2005, Chapter 99, enacted a new section of the state Procurement Code requiring subcontractors for the first time in the State of New Mexico to provide a performance and payment bond when performing all state and local public work projects valued at \$50,000 or more. Bonding of subcontractors is in addition to the bonds required of the general contractor as required by Section 13-4-18. This section, known as the “Little Miller Act”, also requires all construction contracts awarded in excess of \$25,000 to include a performance bond and a payment bond each equal to 100% of the awarded bid amount. The bonds are primarily intended to protect subcontractors and material suppliers by providing a remedy for recovery of monies due for 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” is defined in the Procurement Code as projects that require professional services of architectural or engineering services costing \$25,000 or more; or landscape architectural or surveyors costing \$5,000 or more, excluding gross receipts tax.

The Subcontractor’s Bonding Act has created a number of problems due to vague and ambiguous language and already has required two opinions by the Attorney General to clarify which tier of subcontractors would be affected by the bonding requirement and the beneficiary of the bonds. Enforcement requirements or penalties are not defined in this bill or as the current law is written and requires each public body to develop procedures for implementation.

Requiring subcontractor bonding does not guarantee performance or quality. Collecting on a bond requires notice of default and typically can not be remedied through the bonding company prior to the required date of substantial completion of the project. Most contractors previously

chose to be selective in the subcontractors they chose to use and would lend assistance to subcontractors if they experienced difficulties in completing the job. It is not known if there has been a decrease in subcontractor default as a result of the bonding requirement or the number of claims. These cases would need to be examined to determine the impact to overall projects schedules and added administrative burden.

OTHER SUBSTANTIVE ISSUES

The construction and bonding industry has reported that many small New Mexico contractors cannot obtain bonding and that those who can are paying a premium which is passed on to the owner. A March 3, 2006 article in the New Mexico Business Weekly cites two primary causes: “recent hurricanes and other natural disasters in the U.S. have sapped insurance companies of funds so that many no longer offer construction bonds, and a little-known, eight-month-old state law that requires subcontractors on state public works projects worth over \$50,000 to be bonded is hampering subs in getting jobs.”

Art Cruz, president of Southwest Bonding Associates in Albuquerque, is quoted in the article to say that “there is a construction bond crisis in New Mexico. The inability of local firms to get bonds is forcing both state and federal public works jobs to large, out-of-state firms, and it's causing small local firms to go out of business. In the constricted bond market, insurers also are reluctant to give bonds to small companies that have less than perfect credit histories”.

Sandia Laboratories is reported to have not been able to find small New Mexico construction companies, especially those that do subcontracting work, for the millions of dollars in construction contracts due to difficulty in getting performance bonds.

Section 13-4-37 of 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. This provision will still be in effect regardless if this bill is passed.

ALTERNATIVES

Pre-qualification of contractors by public owners or on a statewide basis by a regulatory agency such as the Construction Industries Division or the Department of Labor would more appropriately provide the protection of general contractors from subcontractor default when performing public works projects. 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.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Public owners and taxpayers will continue to bear the added cost of subcontractor bonding without any additional benefit or protection.

Attachment

LMK/mt