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## FISCAL IMPACT REPORT

ORIGINAL DATE 01/19/11

SPONSOR Asbill and Larranaga LAST UPDATED 02/06/11 HB \_\_\_\_\_

SHORT TITLE Public Works Contract Subcontractor Bonds SB 35/aSEC

ANALYST Wilson

### APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY11	FY12		
	NFI		

(Parenthesis ( ) Indicate Expenditure Decreases)

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Department of Workforce Solutions (DWS)  
 Public School Financing Authority (PSFA)  
 Regulation and Licensing Department (RLD)

### SUMMARY

#### Synopsis of SEC Amendment

The Senate Education Committee amendment to Senate Bill 35 requires a subcontractor to provide a performance and payment bond on a public works building project if the subcontractor's contract for work to be performed on a project is \$200,000 or more instead of \$250,000 or more.

In addition, prior to the close-out payment, the contractor shall provide to the owner a list that has been signed and notarized by the contractor and by each subcontractor whose payment exceeds \$200,000 certifying that the required bonds are in place.

#### Synopsis of Original Bill

Senate Bill 35 amends NMSA 1978 Section 13-1-148.1 to require subcontractors on public works projects to provide a performance and payment bond when the value of the contract for the work is \$250,000 or more. The current law requires a performance and payment bond when the value of the contract for the work is \$125,000 or more.

## **FISCAL IMPLICATIONS**

The PSFA provided the following:

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 general contractor. 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 escalations in average square footage costs since bonding of subcontractors became mandatory in 2005. 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 not to or are unable to bid public works projects.

Raising the threshold from \$125,000 to \$250,000 should increase the number of potential subcontractors able to provide bids to general contractors and decrease the additional bond costs that are passed on to public owners. However, it is most likely that this bill will be revenue neutral.

## **SIGNIFICANT ISSUES**

In 2009, SJM71 created a work group to study the effects of subcontractor bonding and report its findings to the Public School Capital Outlay Task Force (PSCOOTF), Legislative Finance Committee (LFC) and the Legislative Education Study Committee (LESC). This group worked over the two interims to review the costs and benefits of the program and explored alternatives; including prequalification of contractors and the various performance-based procurement methods for public works construction. Due to the economic downturn and depressed construction market in New Mexico, the work group decided that it was probably not the appropriate time to remove the subcontractor bond provisions entirely, but did agree on raising the threshold while they continue to explore the issues.

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% 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.

It has been argued that by adding the requirement of bonding of subcontractors, the public 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.

### **ADMINISTRATIVE IMPLICATIONS**

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 as to the impact to overall project schedule and added administrative burden. It does appear that the annual owner cost of subcontractor bonding statewide is far greater than known general contractor losses due to subcontractor default.

Agencies affected by this bill can handle the provisions of this bill with existing staff as part of ongoing responsibilities.

### **OTHER SUBSTANTIVE ISSUES**

Requiring subcontractor bonding does not guarantee performance or quality. Collecting on a bond requires notice of default, and typically cannot 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 use, and would lend assistance to subcontractors if they experienced difficulties in completing the job.

The Subcontractors Fair Practices Act in 13-4-37 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 if the threshold is increased through enactment of this bill.

### **ALTERNATIVES**

The PSFA suggested the following:

Pre-qualification of contractors and grading of performance by public owners on a statewide basis by a regulatory agency such as Construction Industries Division the DWS 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.