

Department of Legislative Services  
Maryland General Assembly  
2013 Session

FISCAL AND POLICY NOTE

Senate Bill 833 (Senator Brinkley)  
Education, Health, and Environmental Affairs  
and Finance

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**Frederick County - Exemption from State Procurement Laws Concerning  
Minority Business Enterprises and Prevailing Wage Rates**

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This bill exempts one (unspecified) elementary school construction project in Frederick County from State procurement law regarding minority business enterprise (MBE) and prevailing wage requirements. Procurement for the school construction project must begin after the bill's effective date.

The bill takes effect July 1, 2013, and terminates June 30, 2015.

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**Fiscal Summary**

**State Effect:** No effect on total State funding for public school construction, which is established annually by the Governor and General Assembly through the capital budget process. The Public School Construction Program (PSCP) can implement the bill with existing budgeted resources. No effect on revenues.

**Local Effect:** Exempting the Frederick County school construction project from the prevailing wage requirement may reduce the county's share of the cost of that project by between 2% and 5%. MBE exemption does not have a discernible effect on project costs, but it may result in some administrative efficiencies to the extent that the county does not have to comply with program requirements. No effect on Frederick County revenues. **Frederick County did not provide a response in time for inclusion in this fiscal and policy note.**

**Small Business Effect:** Minimal. MBEs may have reduced contracting opportunities on the one school construction project in Frederick County.

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## Analysis

**Current Law:** For a description of State funding for PSCP, please see the **Appendix – State Funding for Public School Construction Projects**.

For a description of the State’s MBE program, please see the **Appendix – Minority Business Enterprise Program**.

In general, local jurisdictions are not subject to State procurement law, which mostly applies to State procurements. However, local jurisdictions are required to abide by the State’s MBE program requirements when procuring school construction contracts for which State funds are being used. Also, the State’s prevailing wage law, described below, applies to some local public works projects for which at least 50% of total funding for the project is State funds.

### *Prevailing Wage*

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, subject to the advice and recommendations of a six-member advisory council appointed by the Governor.

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 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.

**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 exceeding \$500,000. 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 (SB 202) 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. The Department of Labor, Licensing, and Regulation advises that its prevailing wage unit currently monitors more than 500 projects, compared with 187 in fiscal 2011. The total value of those projects has also increased, from \$3.1 billion in fiscal 2011 to more than \$4.1 billion currently, which includes projects procured by local governments. In fiscal 2012, the unit investigated 535 project sites for prevailing wage compliance, recovered \$755,472 in unpaid wages on behalf of laborers, and collected \$218,525 in liquidated damages on behalf of the State and local governments.

Four Maryland jurisdictions – Allegany, 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, including school construction.

For fiscal 2014, Frederick County requested PSCP funding to replace North Frederick Elementary School, which the Board of Public Works approved in January 2013. It also requested planning approval for a new elementary school in the Urbana area, which has not been recommended for approval as of February 19, 2013. It is assumed that procurement for the North Frederick school has already begun and that the bill, therefore, applies to the construction of the new elementary school in the Urbana area or another new elementary school that could be requested in fiscal 2015. With a State share of approximately 60% of eligible costs for school construction projects, most school construction projects in the county are subject to the prevailing wage.

**Local Fiscal Effect:** For recent bills dealing with the State's prevailing wage, the Department of Legislative Services (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.

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 PSCP 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. Recent bid solicitations for three new or replacement schools in Howard and Washington counties used this approach. Based on the lowest submitted prevailing wage bids, the use of prevailing wages increased the bids by 6.6%, 8.2%, and 8.7%, respectively. Although the sample is not large enough to draw any firm conclusions, it is possible that the gap between market and prevailing wages is lower in more urban areas of the State, where there is greater competition for construction projects.

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.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** None.

**Information Source(s):** Board of Public Works; Department of Labor, Licensing, and Regulation; Department of Budget and Management; Department of General Services; Public School Construction Program; Department of Legislative Services

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## Appendix – State Funding for Public School Construction Projects

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Subject to the final approval of the Board of Public Works (BPW), the Interagency Committee on School Construction (IAC) manages State review and approval of local school construction projects. Each year, local systems develop and submit to IAC a facilities master plan that includes an analysis of future school facility needs based on the current condition of school buildings and projected enrollment. The master plan must be approved by the local school board. Subsequently, each local school system submits a capital improvement plan to IAC that includes projects for which it seeks planning and/or funding approval for the upcoming fiscal year, which may include projects that the local system has forward funded. In addition to approval from the local school board, the request for the upcoming fiscal year must be approved by the county's governing body. Typically, the submission letter to IAC contains signatures of both the school board president and either the county executive and county council president or chair of the board of county commissioners.

Based on its assessment of the relative merit of all the project proposals it receives, and subject to the projected level of school construction funds available, IAC makes recommendations for which projects to fund to BPW. By December 31 of each year, IAC must recommend to BPW projects comprising 75% of the preliminary school construction allocation projected to be available by the Governor for the upcoming fiscal year. Local school boards may then appeal the IAC recommendations directly to BPW. By March 1 of each year, IAC must recommend to BPW and the General Assembly projects comprising 90% of the allocation for school construction submitted in the Governor's capital budget. Following the legislative session, IAC recommends projects comprising the remaining school construction funds included in the enacted capital budget for BPW approval, no earlier than May 1.

The State pays at least 50% of eligible costs of school construction and renovation projects, based on a funding formula that takes into account numerous factors including each local school system's wealth and ability to pay. The Public School Facilities Act (Chapters 306 and 307 of 2004, SB 787/HB 1230) requires that the cost-share formula be recalculated every three years. The first recalculation occurred in 2007, and the second recalculation occurred in 2010. **Exhibit 1** shows the State share of eligible school construction costs for all Maryland jurisdictions for fiscal 2012, which was determined by the 2007 recalculation, and for fiscal 2013 through 2015, as determined by the 2010 recalculation. The 2013 recalculation will be conducted prior to fall 2013 for implementation beginning in fiscal 2016.

Chapters 306 and 307 also established the State's intent to provide \$2.0 billion of funding for school construction by fiscal 2013, an average of \$250.0 million each year for

eight years. As a result, the Public School Construction Program funding increased from \$125.9 million in fiscal 2005 to \$253.8 million in fiscal 2006, and it has remained above the \$250.0 million target each year since, which resulted in significant increases in school construction assistance to local school boards. As a result, the State achieved the \$2.0 billion goal ahead of schedule. **Exhibit 2** shows annual State public school construction funding since fiscal 2006, by county.

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

<u>County</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>
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

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**Exhibit 2**  
**State Funding for Public School Construction**  
(\$ in Thousands)

<b>County</b>	<b>FY 2006</b>	<b>FY 2007</b>	<b>FY 2008</b>	<b>FY 2009</b>	<b>FY 2010</b>	<b>FY 2011</b>	<b>FY 2012</b>	<b>FY 2013</b>	<b>Total FY 06-13</b>
Allegany	\$12,000	\$18,650	\$412	\$0	\$0	842	603	741	\$33,248
Anne Arundel	19,457	22,675	27,827	27,420	25,020	26,200	27,400	33,300	209,299
Baltimore City	21,523	39,436	52,665	41,000	27,733	28,559	32,000	42,600	285,516
Baltimore	25,218	35,053	52,250	40,985	28,000	29,000	32,000	43,300	285,806
Calvert	3,437	2,723	12,644	7,824	8,181	8,450	6,907	7,018	57,184
Caroline	4,699	2,935	2,426	8,100	6,000	3,767	86	350	28,363
Carroll	7,434	8,282	8,219	11,741	10,520	8,444	8,905	12,748	76,293
Cecil	8,656	8,271	9,533	2,674	1,538	1,744	2,414	1,514	36,344
Charles	8,267	10,200	13,170	11,704	8,898	8,335	8,630	8,000	77,204
Dorchester	656	872	6,137	10,400	6,469	5,436	3,502	0	33,472
Frederick	11,910	17,942	18,728	14,759	16,226	14,000	16,300	19,092	128,957
Garrett	1,507	1,235	6,243	3,020	666	0	333	0	13,004
Harford	8,287	11,096	16,238	14,751	16,253	13,835	16,206	14,512	111,177
Howard	15,273	17,808	23,206	18,265	18,262	18,290	22,936	32,490	166,530
Kent	2,000	3,479	1,335	0	388	0	0	0	7,202
Montgomery	30,431	40,040	52,297	53,312	28,350	30,183	33,000	43,106	310,720
Prince George's	29,833	37,425	52,250	41,000	28,200	29,500	31,348	40,375	289,931
Queen Anne's	6,897	3,000	3,925	4,951	3,947	5,750	5,195	0	33,665
St. Mary's	3,271	5,495	9,806	7,266	4,028	6,600	3,064	2,314	41,844
Somerset	14,300	12,022	5,153	0	6,000	6,000	3,257	0	46,732
Talbot	2,422	2,405	2,038	0	436	344	0	0	7,645
Washington	6,431	4,478	8,970	9,368	7,965	7,970	8,400	9,000	62,582
Wicomico	7,616	4,178	8,143	12,960	13,170	9,975	1,597	10,808	68,447
Worcester	2,241	6,872	8,213	5,483	403	0	0	0	23,212
MD School for the Blind								2,800	2,800
Bond Premium		6,100							6,100
Statewide						500	47,500	25,100	73,100
<b>Total</b>	<b>\$253,766</b>	<b>\$322,672</b>	<b>\$401,828</b>	<b>\$346,983</b>	<b>\$266,653</b>	<b>\$263,724</b>	<b>\$311,583</b>	<b>\$349,167</b>	<b>\$2,516,376</b>
<b>Over \$250 million</b>	<b>\$3,766</b>	<b>\$72,672</b>	<b>\$151,828</b>	<b>\$96,983</b>	<b>\$16,653</b>	<b>\$13,724</b>	<b>\$61,583</b>	<b>\$99,167</b>	<b>\$516,376</b>

Note: \$25.0 million of the statewide allocation in fiscal 2013 is for the Energy Efficiency Initiative and is to be distributed based on local requests and need for funding to replace inefficient systems.



## Appendix – Minority Business Enterprise Program

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The State’s Minority Business Enterprise (MBE) program, which is scheduled to terminate July 1, 2016, requires that a statewide goal for MBE contract participation be established biennially through the regulatory process under the Administrative Procedure Act. The biennial statewide MBE goal is established by the Special Secretary for the Governor’s Office of Minority Affairs (GOMA), in consultation with the Secretary of Transportation and the Attorney General. In a year in which there is a delay in establishing the overall goal, the previous year’s goal applies. The Special Secretary is also required to establish biennial guidelines for State procurement units to consider in deciding whether to establish subgoals for different minority groups recognized in statute. In a year in which there is a delay in issuing the guidelines, the previous year’s guidelines apply.

Prior to the enactment of Chapters 252 and 253 of 2011 (HB 456/SB 120) and Chapter 154 of 2012 (HB 1370), State law established a goal that at least 25% of the total dollar value of each agency’s procurement contracts be awarded to MBEs, including subgoals of 7% for African American-owned businesses and 10% for woman-owned businesses. As of January 2013, a new statewide goal had not been issued by GOMA, so the 25% statewide goal remains in effect. GOMA issued subgoal guidelines in July 2011, summarized in **Exhibit 1**, which are still in effect. The guidelines state that subgoals may be used only when the overall MBE goal for a contract is greater than or equal to the sum of all recommended subgoals for the appropriate industry, plus two percentage points.

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### Exhibit 1 Subgoal Guidelines Issued July 2011

	<u>Construction</u>	<u>Architectural/ Engineering</u>	<u>Maintenance</u>	<u>Information Technology</u>	<u>Services</u>	<u>Supplies/ Equipment</u>
African American	7%	6%	8%	7%	7%	6%
Hispanic	–	2%	3%	2%	–	–
Asian	4%	–	3%	–	4%	5%
Women	–	9%	–	8%	12%	10%
<b>Total</b>	<b>11%</b>	<b>17%</b>	<b>14%</b>	<b>17%</b>	<b>23%</b>	<b>21%</b>
<b>Total +2</b>	<b>13%</b>	<b>19%</b>	<b>16%</b>	<b>19%</b>	<b>25%</b>	<b>23%</b>

Source: Governor’s Office of Minority Affairs

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There are no penalties for agencies that fail to reach the statewide target. Instead, agencies are required to use race-neutral strategies to encourage greater MBE participation in State procurements.

### *History and Rationale of the MBE Program*

In 1989, the U.S. Supreme Court held in the *City of Richmond v. J.A. Croson Co.*, that state or local MBE programs using race-based classifications are subject to strict scrutiny under the equal protection clause of the Fourteenth Amendment to the U.S. Constitution. In addition, the ruling held that an MBE program must demonstrate clear evidence that the program is narrowly tailored to address actual disparities in the marketplace for the jurisdiction that operates the program. As a result, prior to each reauthorization of the State's MBE program, the State conducts a disparity study to determine whether there is continued evidence that MBEs are underutilized in State contracting.

The most recent disparity study was completed in February 2011 and serves as the basis for the most recent reauthorization of the MBE program. It found continued and ongoing disparities in the overall annual wages, business earnings, and rates of business formation between nonminority males and minorities and women in Maryland. For instance, average annual wages for African Americans (both men and women) and nonminority women were 33% lower than for comparable nonminority males. It also found continued disparities in the use of MBEs compared to their availability in the marketplace to perform work in designated categories of work. For instance, African American-owned businesses were paid 4.5% of State construction contract dollars, but they make up 9.7% of the construction sector in the State. Woman-owned businesses were paid 8.5% of maintenance contract dollars, despite making up 18.0% of the maintenance contract sector. Similar disparities were found in other contracting sectors and for other MBE categories.

Another disparity study is due by December 31, 2015, prior to the July 1, 2016 termination date for the MBE program. (The program has been reauthorized six times since 1990, most recently by Chapter 154 of 2012.) **Exhibit 2** provides MBE participation rates for major Executive Branch agencies for fiscal 2011, the most recent year for which data is available.

### *Requirements for MBE Certification*

An MBE is a legal entity, other than a joint venture, that is:

- organized to engage in commercial transactions;
- at least 51% owned and controlled by one or more individuals who are socially and economically disadvantaged; and

- managed by, and the daily business operations of which are controlled by, one or more of the socially and economically disadvantaged individuals who own it.

MBEs include not-for-profit entities organized to promote the interests of physically or mentally disabled individuals. There are no restrictions on the size or management structure of not-for-profit entities that can be considered MBEs.

A socially and economically disadvantaged individual is defined as a citizen or legal U.S. resident who is African American, Native American, Asian, Hispanic, physically or mentally disabled, a woman, or otherwise found by the State's MBE certification agency to be socially and economically disadvantaged. An MBE owned by a woman who is also a member of an ethnic or racial minority group is certified as either owned by a woman or owned by a racial or ethnic minority, but not both. The Maryland Department of Transportation is the State's MBE certification agency.

A socially disadvantaged individual is someone who has been subject to racial or ethnic prejudice or cultural bias within American society because of his or her membership in a group and without regard to individual qualities. An economically disadvantaged individual is someone who is socially disadvantaged whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities compared with those who are not socially disadvantaged. An individual with a personal net worth in excess of \$1.5 million, adjusted annually for inflation, is not considered economically disadvantaged. The inflation-adjusted limit for calendar 2013 is \$1,615,663.

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**Exhibit 2**  
**MBE Participation Rates, by Agency**  
**Fiscal 2011**

<u>Agency</u>	<u>% MBE Participation</u>
Aging	30.7%
Agriculture	6.9%
Budget and Management	10.5%
Business and Economic Development	43.9%
Education	20.3%
Environment	25.2%
Executive Department	14.0%
General Services	33.9%
Health and Mental Hygiene	46.1%
Higher Education Commission	14.0%
Housing and Community Development	21.9%
Human Resources	8.4%
Information Technology	13.7%
Juvenile Services	8.9%
Labor, Licensing, and Regulation	36.1%
Morgan State University	22.3%
Natural Resources	10.9%
Planning	8.3%
State Police	8.8%
Public Safety and Correctional Services	33.0%
Transportation – Aviation Administration	26.2%
Transportation – Motor Vehicle	46.7%
Transportation – Office of the Secretary	29.5%
Transportation – Port Administration	7.8%
Transportation – State Highway	26.1%
Transportation – Transit Administration	16.8%
Transportation – Transportation Authority	25.4%
University System of Maryland	19.7%
Veterans Affairs	18.2%
<b>Statewide Total<sup>1</sup></b>	<b>23.8%</b>

<sup>1</sup>Includes additional non-Cabinet agencies.

Source: Governor's Office of Minority Affairs

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