SB 204

Department of Legislative Services

Maryland General Assembly
2014 Session

FISCAL AND POLICY NOTE

Senate Bill 204 (Senator Manno, *et al.*)
Finance

Prevailing Wage Rates Reform Act of 2014

This bill expands the applicability of the State's prevailing wage laws, alters the methods by which State prevailing wage rates are determined, and changes penalty provisions related to the nonpayment of prevailing wages on public works projects.

Fiscal Summary

State Effect: General fund expenditures by the Department of Labor, Licensing, and Regulation (DLLR) increase by $609,400 in FY 2015 to monitor and enforce compliance with prevailing wage requirements. Out-year expenditures reflect annualization and inflation. The total project cost of State public works projects valued at between $25,000 and $500,000 may increase by between 2% and 5%. Diminished competition for prevailing wage projects may also increase their cost. As the State's capital budget is fixed annually, total State spending (all funds) on public works projects does not increase, but fewer projects may receive funding each year. General and special fund revenues decrease by about $150,000 annually due to foregone liquidated damage payments, although the general fund and revenue loss may be partially offset by increased revenue from higher civil penalties. FY 2015 foregone revenues are slightly less, which accounts for the bill's effective date.

(in dollars)	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
GF/SF Rev.	($112,500)	($150,000)	($150,000)	($150,000)	($150,000)
GF Expenditure	$609,400	$764,500	$798,600	$834,400	$871,900
Net Effect	($721,900)	($914,500)	($948,600)	($984,400)	($1,021,900)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: The total project cost of local public works projects that are required to pay prevailing wage rates under the bill may increase by between 2% and 5%. Diminished competition for local public works projects may also increase their cost. To the extent that local capital budget expenditures are fixed annually, local expenditures do not increase but fewer projects may receive funding each year. Local revenues decrease by a negligible amount due to foregone liquidated damage payments. **This bill imposes a mandate on a unit of local government.**

Small Business Effect: Meaningful for small construction contractors.

Analysis

Bill Summary:

Applicability of Prevailing Wages: Public bodies required to pay prevailing wages on public works projects include (1) all political subdivisions or agencies, regardless of the amount of State funds used on their public works projects and (2) any other person or entity with respect to construction of a public work for which 50% or more of the money used for construction is from any specified public body. Public bodies do not include a unit of State government or instrumentality of the State, political subdivision, or agency funded wholly from a source other than the State, a political subdivision, or an agency. Public works projects subject to the payment of prevailing wages include any structure or work that is constructed on property owned by or leased to the State, a political subdivision, or agency, regardless of whether public funds are used to pay for construction. Structures or works constructed by a public service company under order of the Public Service Commission remain exempt from prevailing wage requirements, even if they are built on land owned or leased by a public body.

Public works contracts valued at less than $25,000 are exempt from the prevailing wage requirement.

Determination of Prevailing Wage Rates: The prevailing wage rate for straight time is the wage rate established by the most recent collective bargaining agreement in the worker's classification. If there is no wage rate established by collective bargaining agreement for a worker's classification, the Commissioner of Labor and Industry must determine the prevailing wage rate based on the wage rate established by the most recent collective bargaining agreement in the nearest locality within the State that most closely approximates the locality in specified categories.

For multiyear public works projects, prevailing wage rates are recalculated annually by the commissioner for each classification of worker and then applied to the project. Overtime wages must be paid to employees on public works projects who work more than 8 hours in a day, instead of 10 hours.

Liquidated Damages and Penalties: Liquidated damages to the public body for contractors who fail to submit timely payroll records to the commissioner increase from $10 to $500 for each calendar day the records are late. The civil penalty for a contractor who does not post the statement of prevailing wage rates at the site of the public work, as required, increases from $50 to $1,000 per violation. Likewise, the civil penalty for false representation related to prevailing wage payroll records increases from $1,000 to $5,000 for each falsified record.

Liquidated damages for contractors who fail to pay employees the proper prevailing wage increase from $20 to $1,000 per day for each laborer who is paid less than the prevailing wage. These liquidated damages are paid to the employee rather than to the public body. The bill makes additional technical changes to reflect the fact that liquidated damages are paid directly to employees rather than to public bodies. Payment by the employer of restitution to the employee, required under current law, is in addition to, not instead of, payment of liquidated damages to the employee. With regard to suits for recovery of wages, if a court finds that an employer withheld wages or fringe benefits *willfully and knowingly*, the court *must* order payment of double or treble damages; currently, such determinations are at the discretion of the court. Moreover, the bill expands the applicability of provisions related to suits for recovery of wages to encompass actions brought under the subtitle.

In the case of complaints filed by an employee with the commissioner for failure to pay prevailing wages, the commissioner may resolve the issue informally only if the employer has not previously violated the prevailing wage statute.

If a court finds a violation of the prevailing wage statute in any action to which the commissioner is not a party, the court must notify the commissioner, and the commissioner must include that contractor or subcontractor in the list of violators filed with the Secretary of State. Employees retain the right to sue for recovery of unpaid prevailing wages regardless of actions brought by the commissioner.

Current Law: 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.

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 Governor must include at least $385,000 in the budget each year for the Prevailing Wage Unit within DLLR.

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.

The State pays at least 50% of *eligible* school construction costs in all counties, as shown in **Exhibit 1**. Costs that are ineligible for State funding include, among other things, planning and design fees and movable objects or equipment (*e.g.*, furniture or bookshelves). Since total construction costs are higher than eligible construction costs, the State often pays less than 50% of total school construction costs in eight counties that receive a 50% State match of eligible costs.

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

County	FY 2012	FY 2013	FY 2014	FY 2015
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

Chapter 402 of 2013 established the Task Force to Study the Applicability of the Maryland Prevailing Wage Law. The task force held its final meeting on February 24, 2014, but elected not to make any recommendations related to the applicability of prevailing wage requirements. A final report had not been issued at the time this fiscal and policy note was prepared.

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 of $500,000 or more. 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 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. DLLR advises that its prevailing wage unit currently monitors more than 700 projects, compared with 187 in fiscal 2011 and 446 in fiscal 2012. The total value of those projects has also increased, from $3.1 billion in fiscal 2011 to almost $6.0 billion currently, which includes projects procured by local governments. In fiscal 2013, the unit investigated 625 project sites for prevailing wage compliance, recovered $287,000 in unpaid wages on behalf of laborers, and collected $86,000 in liquidated damages on behalf of the State and local governments. It has averaged three prevailing wage inspectors annually.

Five Maryland jurisdictions – Allegany, Charles, 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; Montgomery County exempts school construction projects from its local prevailing wage.

State Expenditures:

Contract Costs: For this bill and recent prior versions of other prevailing wage bills, 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. A similar review of research conducted by DLLR for the Task Force to Study the Applicability of the Maryland Prevailing Wage Law also concluded that "data limitations create difficulty for researchers on both sides of the issue."

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 two counties 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. Data submitted by Carroll County to the task force shows that the cost differential for six school construction solicitations since June 2011 ranged from 3.2% to 8.0%; for all side-by-side solicitations requested since 2007, the average cost differential was 7.2%. Frederick County reported to the task force that a side-by-side solicitation for North Frederick Elementary School had a cost differential of 13.8%.

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.

Therefore, the total project cost of individual State projects that currently fall below the $500,000 contract threshold but are at least $25,000 may increase by between 2% and 5%. However, total State funding for capital projects is not affected, because that funding level is established annually by the Governor and General Assembly through the capital budget process. To the extent that individual project costs increase, fewer projects may be funded annually with available capital resources.

To the extent that the increases in penalties and liquidated damages dissuade some contractors from bidding on State projects, the cost of State public works projects may increase due to the loss of competition for those projects.

Administrative Costs: The bill requires virtually all State and local public works contracts valued at more than $25,000 to pay prevailing wages. The combination of lowering the $500,000 contract value threshold to $25,000 and eliminating the 50% State funding threshold for local projects dramatically increases the number of public works projects that must pay prevailing wages and are, therefore, subject to enforcement oversight by DLLR. In addition, the bill applies to public works projects on land that is owned by or leased to the State that would not otherwise be subject to prevailing wage requirements. DLLR anticipates that these changes increase the number of prevailing wage projects in a given year from about 700 to about 2,500. DLS concurs with this estimate.

The prevailing wage unit within DLLR's Division of Labor and Industry enforces employers' compliance with the prevailing wage as well as the State's living wage law. Given the rapid increase in the number of prevailing wage projects in recent years without additional staff resources, DLLR cannot accommodate any further increase with current staffing levels. Therefore, general fund expenditures by DLLR increase by $609,418 in fiscal 2015, which accounts for the bill's October 1, 2014 effective date. This estimate reflects the cost of adding nine additional wage and hour investigators, one administrator, one assistant Attorney General, and one office clerk to monitor the additional prevailing wage sites, handle the increased workload, and adjudicate penalties. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	12
Salary and Fringe Benefits	$507,208
Operating Expenses	102,210
Total FY 2015 State Expenditures	**$609,418**

Future year expenditures reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

DLLR no longer has to conduct annual wage surveys of construction contractors to determine prevailing wage rates in each jurisdiction. In recent years, that survey process has been automated, so this change results only in modest reductions in administrative burden for DLLR to compile and report the results of the survey. There are no tangible financial savings associated with this change.

Higher liquidated damages combined with those damages being paid to employees and the requirement for the courts to assess double or treble damages in some cases, may increase suits brought to District Court. Any impact on the District Court has not been reflected in this analysis.

State Revenues: Over the past five fiscal years, DLLR has collected an average of $272,000 in liquidated damages, but collections in the last two fiscal years are well below that figure due to increased awareness of and compliance with prevailing wage requirements. That figure includes damages collected for late payroll reporting, which are still paid to the public body that contracts for the public work but are not accounted for separately by DLLR. DLLR has previously estimated that 75% of liquidated damage collections are for State projects. Therefore, DLS estimates that general and special fund revenues decrease due to some liquidated damages being paid to employees instead of to the State; since liquidated damage amounts vary from year to year, a precise estimate is not feasible, but is estimated to be approximately $150,000. DLLR advises that it has not traditionally collected civil penalties, but the increase in those penalties may prompt DLLR to begin collecting them in some instances, resulting in minimal offsetting increases in general fund revenues.

Local Fiscal Effect:

School Construction: Although many local public works projects receive State funds, most do not reach the 50% State funding threshold that makes them subject to the current prevailing wage law. The most notable exception is public school construction projects in some counties. As noted above, counties with a 50% State match for school construction generally do not have to pay prevailing wages. For fiscal 2015, these eight counties are Anne Arundel, Baltimore, Garrett, Kent, Montgomery, Queen Anne's, Talbot, and Worcester counties. In addition, with a State share of 56% and 58%

respectively, some projects in Calvert and Carroll counties may also not qualify for prevailing wages under current law, depending on the distribution of eligible and ineligible costs. By repealing the 50% State funding threshold, however, the bill makes school construction contracts in as many as 10 counties fall under the prevailing wage statute if their value meets or exceeds $25,000. In counties currently required to pay prevailing wages, projects valued at between $25,000 and $500,000 that previously were exempt are also required to pay prevailing wages under the bill. The total project cost of each project required to pay prevailing wages under the bill may increase by between 2% and 5%. To the extent that local capital budget allocations annually, local spending does not increase, but fewer projects may be funded each year.

Community College Construction Grant Program: The Community College Construction Grant program provides funds to assist local governments in the acquisition of property and in the design, construction, renovation, and equipping of local and regional community college buildings, site improvements, and facilities. The level of State support is based on two criteria: (1) the portion of the project that meets the eligibility requirements for State support and (2) the State/local cost-sharing formula contained in statute. The State share of capital projects for regional colleges is 75% of project costs, while other community colleges receive between 50% and 70% of project costs, depending on the wealth of the jurisdiction. This means that all community college capital projects are already subject to the State's prevailing wage requirement and, therefore, are not affected by the bill.

Liquidated Damages: As with the State, counties with public works projects forego liquidated damages that are paid to employees rather than to public bodies under the bill. The extent of the foregone revenue is expected to be negligible for any single county. The higher penalties may also dissuade some contractors from bidding on local projects and may, therefore, result in higher project costs due to the loss of competition during the bidding process.

Small Business Effect: Public works contractors that pay prevailing wages typically pass along any increase in labor costs to the public body that contracts for the work; this applies to the increased pay for overtime work under the bill. The more severe penalty provisions in the bill may create a disincentive for some small contractors that do not have extensive experience with prevailing wage requirements to bid on prevailing wage projects.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Dorchester, Garrett, and Montgomery counties; cities of Frederick and Havre de Grace; Board of Public Works; Department of Budget and Management; Department of General Services; Judiciary (Administrative Office of the Courts); Department of Labor, Licensing, and Regulation; Maryland Association of Counties; Maryland Municipal League; Maryland Department of Transportation; University System of Maryland; Department of Legislative Services

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