SB 711

Department of Legislative Services

Maryland General Assembly
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FISCAL AND POLICY NOTE
First Reader

Senate Bill 711 (Senator Manno, *et al.*)
Finance

Prevailing Wage Rates Reform Act of 2016

This bill expands the applicability of the State's prevailing wage laws, alters the methods by which State prevailing wage rates are determined, and stiffens penalty provisions for violations of various aspects of the State's prevailing wage statute.

Fiscal Summary

State Effect: General fund expenditures by the Department of Labor, Licensing, and Regulation (DLLR) increase by $641,800 in FY 2017 to monitor and enforce compliance with prevailing wage requirements. General fund expenditures by the Department of General Services (DGS) also increase by $111,100 in FY 2017 to assist recipients of State grants and monitor their compliance. Out-year expenditures for both agencies reflect annualization and inflation and the termination of one-time costs. The total project cost of State public works projects valued at between $25,000 and $500,000 may increase, on average, by as much as 10%, but individual project costs will vary. For projects currently paying prevailing wages, total project costs also increase but, to a lesser extent, due to higher prevailing wage rates. 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 work projects does not increase, but fewer projects may receive funding each year. General and special fund revenues decrease by about $117,000 annually (adjusted in FY 2017 due to the bill's effective date) due to forgone liquidated damage payments, although the general fund revenue loss may be partially offset by increased revenue from higher civil penalties.

(in dollars)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF/SF Rev.	($87,800)	($117,000)	($117,000)	($117,000)	($117,000)
GF Expenditure	$752,900	$870,000	$903,600	$938,600	$975,100
Net Effect	($840,600)	($987,000)	($1,020,600)	($1,055,600)	($1,092,100)

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, on average, by as much as 10%. For local public works projects that already pay prevailing wages, total project costs also increase, but to a lesser extent, due to prevailing wage rates increasing. 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 forgone 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: A "public body" includes (1) all political subdivisions or agencies, regardless of the amount of State funds used on their public works projects; (2) any other person or entity with respect to construction of a public school for which 25% or more of the combined money used for construction is from any specified public body; and (3) any other person or entity with respect to construction of any other public work for which 50% or more of the combined 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 combined hourly rates of wages and fringe benefits 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.

The prevailing wage rate for overtime work remains at least 150% of the wage for straight time, except that with the new definition of the wage for straight time, it now is 150% of the combined wage (including fringe benefits), instead of just the regular hourly wage.

For multi-year 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/Background: For a complete description of the State's prevailing wage statute, please see the **Appendix – Maryland's Prevailing Wage Law.** The State pays at least 50% of *eligible* school construction costs in all counties, as shown in **Exhibit 1**.

Exhibit 1
State Share of Eligible School Construction Costs
Fiscal 2015-2018

County	FY 2015	FY 2016	FY 2017	FY 2018
Allegany	93%	88%	83%	83%
Anne Arundel	50%	50%	50%	50%
Baltimore City	93%	93%	93%	93%
Baltimore	50%	52%	52%	52%
Calvert	56%	53%	53%	53%
Caroline	78%	80%	80%	80%
Carroll	58%	59%	59%	59%
Cecil	69%	64%	63%	63%
Charles	63%	61%	61%	61%
Dorchester	69%	76%	76%	76%
Frederick	60%	64%	64%	64%
Garrett	50%	50%	50%	50%
Harford	63%	63%	63%	63%
Howard	60%	55%	55%	55%
Kent	50%	50%	50%	50%
Montgomery	50%	50%	50%	50%
Prince George's	62%	63%	63%	63%
Queen Anne's	50%	50%	50%	50%
St. Mary's	64%	59%	58%	58%
Somerset	82%	100%	100%	100%
Talbot	50%	50%	50%	50%
Washington	71%	71%	71%	71%
Wicomico	96%	97%	97%	97%
Worcester	50%	50%	50%	50%
Maryland School for the Blind	93%	93%	93%	93%

Source: Public School Construction Program

State Expenditures:

Total Project Costs: The appendix notes that, under current law, the Department of Legislative Services (DLS) estimates that prevailing wage projects cost, on average, between 2% and 5% more than they likely would in the absence of prevailing wages. However, the bill's changes to the methodology for calculating prevailing wages likely increases them. First, the exclusive use of collective bargaining agreements to determine wages, rather than a hybrid of prevailing wage and nonprevailing wage projects through the current survey method likely results in higher prevailing wage calculations in many geographic areas and for many trades. Further, the inclusion of fringe benefits in the calculation of overtime, the increase in the number of hours that count as overtime, and the annual recalculation of prevailing wage rates for multi-year projects all serve to increase wages paid to employees on prevailing wage projects. Thus, the 2% to 5% estimated effect under current law likely increases somewhat, although a reliable estimate is not feasible because wage rates for different trades and different areas of the State will be affected differently by the new methodology. Nevertheless, the average gap in total construction costs between prevailing wage and nonprevailing wage projects is not expected to exceed 10% under the bill.

The total project cost increases accordingly for individual State projects that currently fall below the $500,000 contract threshold but are at least $25,000, including those that are on State-owned property but funded with private money (such as public-private partnerships). Likewise, the total project cost increases (to a lesser extent) for projects currently subject to prevailing wage requirements due to the changes in methodology. Even so, 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 $25,000 or more to pay prevailing wages. It also requires public work projects funded wholly or in part by any public money to pay prevailing wages, even if they are constructed by entities that are not public bodies. The combination of lowering the $500,000 contract value threshold to $25,000, eliminating the State funding thresholds for local projects, and including public work projects built by entities that are not public bodies 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. DLS anticipates that the number of prevailing wage projects subject to DLLR oversight at least doubles from current levels.

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. DLLR cannot accommodate any further increase in responsibilities with current staffing levels. Therefore, general fund expenditures by DLLR increase by $641,758 in fiscal 2017, which accounts for the bill's October 1, 2016 effective date. This estimate reflects the cost of adding six additional wage and hour investigators, one administrator, one supervisor, one assistant Attorney General, and two office clerks to monitor the additional prevailing wage sites, handle the increased workload, and adjudicate penalties. It also includes funding for modest information technology (IT) upgrades and informational materials for contractors who are not familiar with prevailing wage requirements. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	11.0
Salaries and Fringe Benefits	$498,148
One-time IT and Outreach	50,000
Ongoing Operating Expenses	93,610
Total FY 2017 DLLR Expenditures	**$641,758**

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

The scope of DLLR's annual wage surveys to determine prevailing wage rates in each jurisdiction is dramatically reduced by the bill. Instead of surveying all contractors, DLLR only needs to survey construction trade unions and firms that participate in collective bargaining agreements with those unions in each jurisdiction. In recent years, the 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 from substantially fewer respondents. There are no tangible financial savings associated with this change. However, there may be modest IT costs associated with expanding the current online payroll reporting system to accommodate more contractors.

In addition, the Capital Grants and Loans Division at DGS oversees more than 100 entities that receive capital grants from the State that are now required to pay prevailing wages. Many of these entities are small nonprofit organizations that lack staff and expertise to monitor capital construction projects and, therefore, require substantial guidance from DGS in managing their projects and ensuring that they comply with the terms of their grant. Requiring them to pay prevailing wage will further tax the staffing resources of the division that oversees them. Therefore, general fund expenditures by DGS increase by $111,132 in fiscal 2017, which accounts for the bill's October 1, 2016 effective date. This estimate reflects the cost of adding two administrative staff to advise and oversee approximately 100 recipients of State grants to ensure compliance with prevailing wage requirements. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	2.0
Salaries and Fringe Benefits	$97,640
Ongoing Operating Expenses	13,492
Total FY 2017 DGS Expenditures	**$111,132**

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

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 calendar years, DLLR has collected an average of $156,600 in liquidated damages, which are paid for both transportation and other State construction projects. That figure includes minimal damages collected for late payroll reporting, which under the bill 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 annually 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 the annualized amount is estimated to be approximately $117,000 (with a lower amount in fiscal 2017 due to the October 1 effective date). DLLR advises that it has not traditionally collected civil penalties or liquidated damages for failure to post prevailing wage rates at a work site, 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: The total project cost of local public works projects that are required to pay prevailing wage rates under the bill may increase, on average, by as much as 10%. 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. Under the bill, however, all local public works projects are subject to the prevailing wage if they have a contract value of at least $25,000. This includes school construction projects, even though most such projects are already subject to the prevailing wage if their contract value meets the $500,000 threshold. For local public works projects that *already* pay prevailing wages, total project costs also increase, but to a lesser extent, due to prevailing wage rates increasing because of the change in methodology. Even so, to the extent that local capital budget expenditures are fixed annually, local expenditures do not increase but fewer projects may receive funding 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 forgo liquidated damages that are paid to employees rather than to public bodies under the bill. The amount of forgone 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: SB 204 of 2014, a similar bill, received a hearing in the Senate Finance Committee, but no further action was taken.

Cross File: HB 721 (Delegate Davis, *et al.*) **-** Economic Matters.

Information Source(s): Baltimore City; Kent and Montgomery counties; Maryland Association of Counties; towns of Bel Air and Leonardtown; Judiciary (Administrative Office of the Courts); University System of Maryland; Public School Construction Program; Department of Budget and Management; Department of General Services; Department of Labor, Licensing, and Regulation; Board of Public Works; Maryland Department of Transportation; Department of Legislative Services

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Appendix – Maryland's Prevailing Wage Law

Contractors and subcontractors working on eligible public works projects in Maryland must pay their employees the prevailing wage rate. "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.

Eligible public works projects are:

- those carried out by the State;
- an elementary or secondary school for which at least 25% of the money used for construction is State money; and
- any other public work for which at least 50% of the money used for construction is State money.

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 (1) 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 or (2) specified construction projects carried out by public service companies under order of the Public Service Commission.

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 based on annual surveys of contractors and subcontractors working on both public works and private construction projects.

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 the Department of Labor, Licensing, and Regulation (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.

History of the Prevailing Wage: 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. Chapters 281 and 282 of 2014 further lowered the State funding threshold for school construction projects to 25% of total construction costs, making virtually all K-12 school construction projects in the State eligible for payment of prevailing wages, subject to the $500,000 contract value threshold.

The number of prevailing wage projects has risen dramatically in recent years. DLLR advises that, in calendar 2015, its prevailing wage unit monitored more than 1,500 projects, compared with 187 in fiscal 2011 and 446 in fiscal 2012. To accommodate the increase in projects, the number of prevailing wage investigators increased in fiscal 2016, from three to six, with each having a caseload of about 200 projects at any given time.

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's prevailing wage ordinance does not apply to school construction projects.

Research on the Effects of Prevailing Wage on Contract Costs: The Department of Legislative Services (DLS) regularly reviews research on the effect of prevailing wage laws on the cost of public works contracts and has found inconsistent and/or unreliable 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. Another deficiency in the research is that it almost always relies on project bid prices (*i.e.*, the anticipated cost prior to the beginning of construction) rather than actual final costs. As most construction projects experience change orders or cost overruns affecting their cost, reliance on bid prices negatively affects the validity of the findings. 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 then 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 and data quality challenges identified above.

More recent empirical data from several 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 provided to the Public School Construction Program by Anne Arundel, Carroll, Frederick, Howard, and Washington counties from 2012-2015 shows that the cost differential between bids with and without prevailing wages for 266 individual bids submitted for 26 different school construction and renovation projects averaged 11.7%, with a range from 0% to 49%. As with other research data, these represent bid prices, not actual construction costs.

These empirical findings have been countered over the past 10 to 15 years by multiple large-scale studies that have found no statistically significant effect of prevailing wages on contract costs. As with the earlier studies that found a project cost effect, control group, and data quality issues may have also affected these studies' findings, but the studies themselves cited the following possible explanations for the absence of a cost effect:

- 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, and supported by the federal Bureau of Labor Statistics, is that labor costs represent between 20% and 30% of construction costs. Therefore, a 10% gap between prevailing wages and market wages could theoretically increase total contract costs by about 2.5%, and a 40% gap in wages could increase total contract costs by about 10%. That is consistent with the findings of some of the empirical studies that have been conducted, but as noted above, more recent empirical 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, with some projects exhibiting higher cost differences and others experiencing negligible differences.