HB 468

Department of Legislative Services
Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 468 (Delegate McCray, *et al.*)
Economic Matters

Procurement - Prevailing Wage - Application to Leased Properties

This bill requires, under specified conditions, that prevailing wages be paid for specified work on property leased by the State or a local government, or that is subject to an agreement to be subsequently leased by the State or a local government.

The bill takes effect July 1, 2017; it applies only prospectively and does not affect any property leased by the State or local governments before that date.

Fiscal Summary

State Effect: General fund expenditures by the Department of Labor, Licensing, and Regulation (DLLR) increase by $269,900 in FY 2018 to conduct outreach and monitor compliance with the bill. Out-year costs reflect annualization, annual salary increases, elimination of one-time costs, and ongoing operating costs. No effect on revenues.

(in dollars)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Revenues	$0	$0	$0	$0	$0
GF Expenditure	269,900	181,300	187,400	193,800	200,600
Net Effect	($269,900)	($181,300)	($187,400)	($193,800)	($200,600)

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

Local Effect: Local governments may experience higher commercial lease rates on property they lease from private entities. No effect on local revenues. **This bill may impose a mandate on a unit of local government.**

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The bill requires payment of prevailing wages on any contract valued at more than $500,000 for the construction of a structure or work that is constructed on property (1) that is at least 55% leased by the State or a political subdivision of the State or (2) subject to an agreement to be subsequently leased by the State or a political subdivision if the property or premises measures more than 20,000 square feet. The requirement to pay prevailing wages applies even if no public money is used to pay for the construction of the structure or work.

Current Law/Background: For a complete description of the State's prevailing wage requirement, please see the **Appendix – Maryland's Prevailing Wage Law**.

The Department of General Services' (DGS) Office of Real Estate's portfolio includes approximately 282 leases of commercial space totaling 4.8 million net usable square feet with an annual rent of $88 million. It advises that almost all leases involve at least some build outs, or "fit-up" work, to customize the space for State use. Information is not available on how many of those leases involve at least 55% of the available space in a building or at least 20,000 square feet of space.

State Expenditures: The bill increases, potentially by a significant amount, the number of capital construction projects subject to the prevailing wage. However, a valid estimate of the potential number of projects affected is not feasible because reliable information on the number of buildings leased by the State and local governments that meet the bill's criteria is not available. The Department of Legislative Services (DLS) notes that the bill affects improvements to a leased building that are not requested by either the State or a local government, as long as the building meets the bill's criteria. This means that, if another tenant in such a building requests an improvement, and the contract meets the $500,000 threshold, prevailing wages must be paid by the contractor. The bill also indicates that it does not apply to property leased before the bill's effective date. DLS assumes that the intent of the bill is to apply to any property whose lease is renewed by the State or a local government after the bill's effective date, even if the property was originally leased before the effective date.

The bill has two effects on State expenditures. First, the cost of leases paid by the State likely increases. Work done on leased buildings is paid for by the landlord, but the landlord likely passes on any increased costs to the tenants. To the extent that payment of the prevailing wage increases the cost of an improvement to a building leased by the State, the cost is likely passed on to the State through higher lease payments.

The second effect is the increase in the number of prevailing wage projects that must be monitored by DLLR. As described in the Appendix, the number of prevailing wage projects has increased tenfold in about six years, while the number of prevailing wage investigators has only doubled. Therefore, DLLR cannot handle any meaningful increase in the number of projects to be monitored with existing resources. Also, since the projects are not traditional public works projects carried out by public entities as defined in current law, DLLR has no way of tracking these projects, so it has to conduct outreach to the commercial real estate industry as well as with State entities and local governments and update its database system to accommodate a new type of project.

Therefore, general fund expenditures by DLLR increase by $269,884 in fiscal 2018, which accounts for a 90-day start-up delay from the bill's July 1, 2017 effective date. This estimate reflects the cost of hiring one wage and hour investigator and one administrative specialist to conduct outreach to the commercial real estate community and local governments and to monitor and enforce a larger number of prevailing wage projects. It also includes the cost of upgrading and maintaining DLLR's prevailing wage database. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Position(s)	2
Salaries and Fringe Benefits	$91,416
Database Upgrade and Maintenance	160,675
Other Operating Expenses	17,793
Total FY 2018 State Expenditures	**$269,884**

Future year expenditures reflect full salaries with annual increases and employee turnover and ongoing operating expenses, including database maintenance costs. If the number of new projects is greater than 250, which is the approximate caseload of a single prevailing wage investigator, the general fund expenditure increase is larger in order to hire more investigators.

The bill has an operational effect on DGS's Office of Real Estate, which negotiates and manages most State leases. Under the bill, the office must determine which leases meet the bill's criteria and likely notify DLLR that any work performed under the lease must be monitored for compliance. DGS can carry out these responsibilities with existing resources.

Local Expenditures: Local governments likely experience an increase in lease payments for leased buildings to the extent that buildings they lease meet the bill's criteria.

Small Business Effect: Commercial real estate landlords and small construction companies that do building improvements may, in some instances, have to comply with all prevailing wage requirements. They may have higher costs associated with building improvements to the extent that they lease to the State or local governments. In most cases, those costs are passed on to tenants, so there is no net effect.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Maryland Association of Counties; Department of Budget and Management; Department of General Services; Department of Labor, Licensing, and Regulation; Department of Legislative Services

Fiscal Note History: First Reader - February 20, 2017
fn/ljm

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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, or $250 per laborer per day if the employer knew or reasonably should have known of the obligation to pay 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 almost all public school construction projects in the State required to pay the prevailing wage, subject to the $500,000 contract value threshold.

The number of prevailing wage projects has risen dramatically in recent years. DLLR advises that its prevailing wage unit currently monitors about 2,300 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 250 projects at any given time; there are currently five filled positions.

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 which is 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.