This bill requires that undisputed retainage proceeds on State construction contracts that are retained by a State agency or a contractor be paid within 90 days after the substantial completion of a project, as defined by the applicable contract or subcontract.

**Fiscal Summary**

**State Effect:** State expenditures (all funds) may increase due to double payment for some components of State construction projects, as discussed below. No effect on revenues.

**Local Effect:** None.

**Small Business Effect:** Meaningful.

**Analysis**

**Current Law:** “Payment security” means security to guarantee payment for labor and materials, including leased equipment, under a contract for construction. “Performance security” means security to guarantee the performance of a contract for construction. Before a public body, including the State, awards a construction contract exceeding $100,000, the contractor must provide payment and performance security. Performance security must be in an amount the public body considers adequate, and payment security must be at least 50% of the total amount payable under the contract. Different requirements apply for construction contracts valued at $100,000 or less. Security must be (1) a bond executed by a surety company authorized to do business in the State; (2) cash in the amount equivalent to a bond; or (3) other security that the public body considers satisfactory.
In general, retainage is a portion of the final payment due to the contractor that is withheld pending final completion of a project. If a contractor has furnished 100% payment security and 100% performance security, the percentage specified in the contract for retainage may not exceed 5% of the total amount. A contractor may not retain a percentage of payments due to a subcontractor that exceeds the percentage retained by the State.

**State Expenditures:** The bill requires payment of retainage upon *substantial*, rather than *final*, completion of a project. This generally means that payment is made prior to the completion of the “punch list,” a construction industry term that refers to a list of items that, toward the end of a project, the contractor and project sponsor agree must be addressed by a contractor before a project is considered complete. Often the items on the punch list are minor, such as scratches or markings on a wall, but the punch list may also include items that require rework.

The Department of General Services (DGS), Maryland Department of Transportation, and the University System of Maryland all advise that retainage provides an incentive for contractors to quickly and completely perform the items on the punch list to bring a project to completion so they can receive their final payment. Payment of retainage prior to completion of the punch list means that contractors have no incentive to complete the items, which may require agencies to contract with a third party to finish the work, resulting in double payment for the work. Therefore, to the extent that contractors do not complete punch list items following payment of retainage, State expenditures (all funds) for construction projects may increase, but a reliable estimate of the overall effect is not feasible.

The Department of Public Safety and Correctional Services advises that it already releases retainage upon substantial completion of a project, so the bill has no effect on the department. DGS also advises that it has discretion to reduce retainage and regularly uses this discretion.

**Small Business Effect:** Small construction companies that work on State construction projects likely are paid their retainage payments sooner than they are paid under current law.

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**Additional Information**

**Prior Introductions:** HB 763 of 2020 received a hearing in the House Health and Government Operations Committee, but no further action was taken.

**Designated Cross File:** None.