

Department of Legislative Services
Maryland General Assembly
2022 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 553

(Senator Patterson)

Budget and Taxation

State Finance and Procurement - Retention Proceeds

This bill requires that undisputed retention 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. **The bill takes effect June 1, 2022.**

Fiscal Summary

State Effect: No effect in FY 2022. State expenditures (all funds) may increase beginning in FY 2023 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 once the site is operational but 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) advises 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 are not incentivized to complete the items (or to do so on a timely basis), which may require agencies to contract with a third-party to finish the work, resulting in double payment for the work. The Maryland Department of Transportation (MDOT) interprets the bill as allowing it to keep retainage amounts (as “disputed” amounts) until completion of the punch list items; the department further indicates that, to the extent the bill does *not* allow for this, MDOT’s ability to ensure completion of punch list items is limited. 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.

Additional Information

Prior Introductions: HB 763 of 2020 and HB 327 of 2021, nearly identical bills, each received a hearing in the House Health and Government Operations Committee, but no further action was taken on either bill.

Designated Cross File: None.

Information Source(s): University System of Maryland; Department of General Services; Department of Public Safety and Correctional Services; Board of Public Works; Maryland Department of Transportation; Department of Legislative Services

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Analysis by: Michael C. Rubenstein

Direct Inquiries to:
(410) 946-5510
(301) 970-5510