

Department of Legislative Services
Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 859 (Frederick County Delegation)
Economic Matters

Procurement - Prevailing Wage Rate - Applicability to Public School
Construction Projects in Frederick County

This emergency bill specifies that changes to the prevailing wage rate enacted by Chapters 281 and 282 of 2014 do not apply to procurement contracts executed by Frederick County on or after this bill's effective date for the construction of three designated public schools. The bill also authorizes Frederick County and a contractor that signed a contract on or after July 1, 2014, for the construction of a new Frederick High School to voluntarily renegotiate the terms of the contract to be bound by the prevailing wage rate in effect prior to the enactment of Chapters 281 and 282.

Fiscal Summary

State Effect: None. The bill applies only to Frederick County.

Local Effect: Frederick County advises that the bill may reduce the total construction cost of the two new elementary school projects referenced in the bill by approximately 13% or a combined total of approximately \$10.5 million. The remaining cost to build Frederick High School may also be reduced to the extent that the county can renegotiate the prospective terms of the existing contract. Any savings generated by the bill enables Frederick County to apply those funds to other capital projects.

Small Business Effect: Minimal.

Analysis

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

Chapters 281 and 282 of 2014 lowered the State funding threshold above which public school construction projects must pay the prevailing wage from 50% to 25%. In fiscal 2015, when Chapters 281 and 282 took effect, the State paid 60% of *eligible* public school construction costs in Frederick County under the State/local cost share formula for school construction, but often less than 50% of *total* public school construction costs, exempting those projects from the prevailing wage requirement. With the lower 25% threshold enacted under Chapters 281 and 282, school construction contracts in Frederick County executed on or after July 1, 2014, are required to pay prevailing wages.

The Frederick County Board of Education executed a contract for the construction of Frederick High School shortly after the enactment of Chapters 281 and 282. Frederick County attributes cost overruns on the project, at least in part, to the payment of prevailing wages, which were not factored into the original cost projections that predate the enactment of Chapters 281 and 282. Under the bill, the county could renegotiate the terms of that contract so that it would not have to pay prevailing wages for the remaining portions of the contract to complete the high school. In August 2015, Frederick County Executive Jan Gardner advised the county board of education that the county could not afford to concurrently build two new elementary schools because the projected cost of the two projects had increased, which the county executive attributed, at least in part, to the payment of prevailing wages. Under the bill, contracts for those two schools, which have not yet been executed, would not be required to pay the prevailing wage.

Additional Comment: The Department of Legislative Services notes that the bill refers to the “prevailing wage rates” in effect before and after the enactment of Chapters 281 and 282, but those two pieces of legislation did not affect or alter the prevailing wage rates that are paid. As the appendix describes, those rates are calculated annually by the Commissioner of Labor and Industry, and the legislation did not change the wage rates in effect in Frederick County. Rather, the legislation altered the criteria used to determine whether a project must pay employees a prevailing wage. Thus, it is not clear whether the bill, as drafted, in fact exempts the designated projects from having to pay the prevailing wage.

Also, school construction contracts are executed by the Frederick County Board of Education, not Frederick County, as referenced in the bill.

Additional Information

Prior Introductions: None.

Cross File: SB 1029 (Senator Hough) - Finance.

Information Source(s): Frederick County; Public School Construction Program; Department of Labor, Licensing, and Regulation; *Frederick News-Post*; Department of Legislative Services

Fiscal Note History: First Reader - March 3, 2016
kb/rhh

Analysis by: Michael C. Rubenstein

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

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.