

**STATE and LOCAL
FISCAL IMPACT**

Drafting Number: LLS 13-0361
Prime Sponsor(s): Rep. Fischer
 Sen. Tochtrop

Date: February 13, 2013
Bill Status: House Business, Labor, Economic, and
 Workforce Development
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TITLE: CONCERNING PAYMENT OF AMOUNTS DUE UNDER A CONSTRUCTION AGREEMENT.

Fiscal Impact Summary	FY 2013-2014	FY 2014-2015
State Revenue		
State Expenditures	See State Expenditures section.	
FTE Position Change		
Effective Date: Upon signature of the Governor, or upon becoming law without his signature.		
Appropriation Summary for FY 2013-2014: None required.		
Local Government Impact: See Local Government Impact section.		

Summary of Legislation

This bill establishes standards to govern construction agreements valued at \$100,000 or more between contractors, subcontractors, and project owners, including both private parties and public entities. In particular, the bill concerns payment terms, including progress payments, payment schedules, and limitations on retainage.

Major features of the bill include the following provisions:

- After receiving an invoice for a progress payment, owners have no more than 25 days to pay the contractor (30 days if no subcontractor is to be paid); except that owners and contractors may include in the agreement and bid documents an extended schedule of up to 60 days for progress payments.
- Contractors must pay subcontractors for invoiced work no later than 5 days after receiving payment from the owner.
- Late payments accrue interest at a rate of 12 percent per year.
- Retainage is limited to 5 percent of the value of each invoice, and under certain conditions the owner must release all retainage to a subcontractor that has completed its work prior to the substantial completion of the entire project.
- Subcontractors may suspend work if the owner or contractor has failed to make timely payments to that subcontractor.

The bill also establishes standards for the invoicing and payment of additional work that has not been documented in a written change order. Construction agreements involving residential projects of one or two dwelling units are exempt from the bill.

Background

Through its various departments and agencies, including institutions of higher education, the state is the owner party in a significant number of construction projects each year. As an example, the University of Colorado system completed over 400 construction projects in 2012, though only a fraction of those projects would meet the \$100,000 threshold to be affected by the bill.

The Capital Construction Fund, managed by the Department of Personnel and Administration (DPA), has funded an average of \$230.6 million in construction projects each of the last 10 fiscal years. The Capital Construction Fund does not include projects at institutions of higher education or federally-funded (*e.g.*, highway) projects.

Construction projects valued at \$100,000 or more typically involve a general contractor that employs a succession of subcontractors over the course of a job.

State Expenditures

The bill increases workload and potentially increases costs to state agencies that administer or fund construction projects. Statewide fiscal impacts under the bill may result from:

- more contracts (those between \$100,000 and \$150,000) subject to state contracting rules;
- progress payments due at 45 days under current law now due at 25 days from receipt, with a penalty of 12 percent annual interest for late payments;
- demobilization, remobilization, and other incidental costs when subcontractors suspend work for nonpayment; and
- increased work and risk associated with release of subcontractor retainage prior to substantial completion.

The effect on individual agencies is described below. Due to opportunities to mitigate fiscal impacts, increased cost to any particular agency can not be estimated and the fiscal note assumes that the need for additional staff or funding, if any, will be addressed through the annual budget process.

DPA. Workload of the accounting group in DPA will increase as additional construction projects become subject to state contracting rules and if progress payments become due before the 45 days of aging allowed under current law. To the extent that the bill strains DPA's ability to make timely payments to contractors, costs for construction projects may increase. The maximum impact on state contracting costs is estimated as the result of 20 days late payment (the difference of paying at 45 days after the pay application, based on current law, and at 25 days under the bill) on the average of \$230.6 million in annual contracting payments, or \$1.5 million annually.

The fiscal note assumes that DPA will adjust its accounting and contracting practices, conforming to the bill to the extent feasible. For example, as the bill is implemented, the office of the state architect in DPA will experience increased workload to review and revise state contracting forms. Cost increases in construction projects will be mitigated by standardized forms, including an extended progress payment schedule.

Judicial Branch. Workload in the courts will increase as the bill becomes effective for both public and private construction agreements, increasing the number of cases and the issues presented in the current caseload of the courts. In addition to enforcement of various payment terms, the courts are empowered to void contractual provisions contrary to the bill. The resulting increase in workload for the courts will be significant but will not require new appropriations.

Other state agencies. The Department of Transportation (CDOT), as well as institutions of higher education and certain other state agencies, engage in construction projects beyond the capital construction oversight of the DPA. To ensure compliance with the bill, these state agencies may seek legal advice, with associated cost increases. The fiscal note assumes that CDOT, institutions of higher education, and other agencies have increased costs and risks similar to DPA and will adhere to similar implementation strategies.

Local Government Impact

The bill results in increased workload and potential increased costs for local governments. Local governments routinely undertake construction projects over \$100,000, such as road improvements, parks and recreation facilities, civic buildings, and public housing projects. To administer these projects under the bill, local governments must either develop and negotiate new contract forms or adjust accounting practices to regularly process progress payments in 25 days.

Local governments are affected by the bill's provisions in the same manner as state agencies. The fiscal note therefore assumes that significant impacts may be addressed through the adjustment of local government accounting and contracting practices.

Departmental Differences

The fiscal note concludes that workload in state agencies, including institutions of higher education, will increase under the bill. This workload increase is indefinite, depending on implementation strategy, but may be managed without new appropriations.

Certain institutions of higher education calculated their increased administrative costs for implementation and continued operations under the bill. Increased costs were calculated by:

- Ft. Lewis College (\$32,000 for 0.5 FTE);
- The University of Colorado system (\$159,300 for 3.0 FTE); and
- Colorado School of Mines (\$50,000 for 1.0 FTE).

In addition, the University of Colorado system calculated a cost of \$637,500 for increased site visits, under the assumption that more frequent assessment of work in place is necessary for release of retainage. However, the University of Colorado system's estimate did not discount projects under \$100,000 or variability in the scope of work or number of subcontractors.

As noted in the fiscal note analysis, to avoid some or most increased costs, state agencies may take appropriate measures, such as revising contracts under the bill's provision for extended progress payments. Any increased costs that are unavoidable or otherwise justified can not be estimated prior to implementation of the bill; such costs will be addressed in the annual budget process.

Departments Contacted

Transportation
Local Affairs
Judicial
Law

Personnel and Administration
Labor and Employment
Counties
Municipalities

Higher Education
Corrections
Agriculture