

MINUTES OF THE SENATE COMMITTEE ON TRANSPORTATION AND TOURISM

The meeting was called to order by Chairman Ben Vidricksen at 9:05 a.m. on February 3, 1998 in Room 254-E of the Capitol.

All members were present except:

Committee staff present: Hank Avila, Legislative Research Department
Bruce Kinzie, Revisor of Statutes
Marian Holeman, Committee Secretary

Conferees appearing before the committee: Tom Slattery, Associated Gen'l Contractors
Mike Lackey, Asst. Sec'y KDOT
Trudy Aron, American Inst. Of Architects
Chris McKenzie, League of Ks. Municipalities
Judy Moler, Ks. Assn. Of Counties
Shirley Moses, Ks. Dept. Of Adm.
Thaine Hoffman, Dir. Div. Of Architectural Svcs.
Michelle Miller, Johnson Co. Government

Others attending: See attached list

Chairman Vidricksen advised that due to the last minute appearance of so many conferees on SB-489, there obviously would be no time for the scheduled discussion and final action on SB-167. It will be rescheduled as soon as possible. He apologized for the inconvenience.

SB-489: Re construction contracts - establishing procedure for partial payment.

Tom Slattery, Executive Vice-President Associated General Contractors of Kansas, Inc. requested introduction of the bill and appeared to testify in support of it. He introduced their legal counsel, Dan Foltz, who would help answer industry or legal questions that might arise. He explained "retainage", the four major issues contained in the bill, and technical changes to make current statutes conform to the new language in SB-489 (Attachment 1)

Mike Lackey, Kansas Department of Transportation, Assistant Secretary and State Transportation Engineer stated they have no objection to the 5% retainage, but object to the escrow account provisions of the bill (Attachment 2). Due to the volume of contracts involved, such an account would be a bureaucratic nightmare for KDOT.

Trudy Aron, Executive Director, American Institute of Architects in Kansas (AIA), speaking as an opponent of the bill, advised of the problems which necessitate present level of retainage and control of funds (Attachment 3).

Chris McKenzie, Executive Director, League of Kansas Municipalities, outlined the principles of their 530 member cities' objections to this bill (Attachment 4).

Judy Moler, Kansas Association of Counties, concurred with preceding testimony given by Chris McKenzie, especially regarding issues of local control, retainage cap and escrow. See her written testimony (Attachment 5) for additional input regarding county concerns with the bill.

Shirley Moses, Kansas Department of Administration, Director of Accounts and Reports, addressed problems with the escrow account section of this bill (Attachment 6). She questioned whether or not her Department, statutorily, can allow state funds to be controlled by someone outside the state system. She cannot conceive of how setting up accounts on an individual basis, as called for in this bill, could be accomplished and overseen.

Michelle Miller, Inter-governmental Relations Coordinator for Johnson County (no written testimony), registered Johnson County Board of County Commissioners' opposition to this bill, particularly, reduction of the retainage fee to 5%. She added they would like more time in which to study the effects of the bill.

CONTINUATION SHEET

MINUTES OF THE COMMITTEE ON TRANSPORTATION AND TOURISM, Room 254-E,
Statehouse, at 9:05 a.m. on February 3, 1998.

Thaine Hoffman, Director, Division of Architectural Services, voiced his Services' opposition to the bill stating that many of his points had already been covered. They differ from KDOT in that many of their projects are much smaller and 5% retainage doesn't provide much leverage to get projects completed satisfactorily. Obvious problems exist with the escrow provision (Attachment 7). They have different problem because of all the small details involved in their projects. In his experience the amount of the contract doesn't make any difference in completion problems. He feels this escrow issue would cost the state money because of administration problems.

Don Foltz, Vice-President AGC of Kansas and President of Kansas Building Systems and Commercial Building Contractors in Topeka commented that in many of the presentations today, decrease in leverage was often mentioned. He stated that retainage is sometimes used in that manner. However, it is not necessary. In almost every contract they have (they do a lot of federal contracting that does not require any retainage), every bill presented is itemized by sub-contract and often times retainage becomes an easy way to cover something "not quite up to snuff." Whereas, if retainage isn't there, employing a pro-active approach to the pay application review; going right to the source and immediately marking it down gives them all the leverage needed to insure performance on a project. The owner's representative reviews the pay application and has the authority to line item any thing they feel is not satisfactory at any time.

Mike Leakey advised KDOT "pre-qualifies" all contractors and that is more effective than retainage. The committee will have to return to this bill as soon as it can be scheduled.

Meeting adjourned at 10:05 a.m.

The next meeting is scheduled for February 4, 1998.

SENATE TRANSPORTATION AND TOURISM
COMMITTEE GUEST LIST

DATE: FEBRUARY 3, 1998

NAME	REPRESENTING
Ron Secher	Department of Admin
Thaine Hoffman	Div. of Arch Services
Evan L. ELL	Kansas Farm Bureau
SHIRLEY MOSES	Dept of Admin / DIV of Accs & REPORT.
DAN FOLTZ	Associated General Contractors of Ks.
Ron Eisenbarth	Ks Alcohol & Drug COUNSELLORS ASS'N
Steve Johnson	Ks Comm. ASAD ASSN
Trud O'ARON	Am INST of Arch. Techs / Ks
Mike Lackey	KDOT
Ed Hayes	KFB
Bill Watts	KDOT
WILLIAM KROUPA	KFB
Joie Stramburg	SoCo
Julie Molen	KAC
Chris McKern	League of Ks. Municipalities
Michelle Miller	Johnson County
George Barber	Barber & Associates
Russ Bruce	KFB
Ronald Butler	KFB

SENATE TRANSPORTATION AND TOURISM
COMMITTEE GUEST LIST

DATE: FEBRUARY 3, 1998

NAME	REPRESENTING
Doug Keestig	KFB
Ray Kennedy	KFB
LES DRUM	KFB
Valera Drum	KFB



TESTIMONY BEFORE THE SENATE TRANSPORTATION COMMITTEE

BY THOMAS E. SLATTERY, EXECUTIVE VICE PRESIDENT

ASSOCIATED GENERAL CONTRACTORS OF KANSAS, INC.

FEBRUARY 3, 1998

Chairman Vidricksen and members of the committee, Senate Bill 489 was introduced at our request and is also supported by the Kansas Contractors Association, the Heavy Constructors of Kansas City and the Builders Association/AGC of Kansas City.

Since retainage is not a concept that the average person deals with on a regular basis, I would like to take just a moment to explain this unique aspect of the commercial construction industry. Typically on a commercial construction project, the contractor submits monthly pay requests for work completed and materials used to that point. After the pay request is approved by the architect or engineer, it is common practice for the public owner, school district, KDOT, city or regents institution to withhold a portion of the pay request, sometimes as high as 10%. This money withheld is called retainage. The retainage is continued on subsequent payments to the contractor through the rest of the project. However, after the job is 50% complete the percent withheld is sometimes reduced through the rest of the project. For example, on a ten million dollar building project the first request for payment might be five hundred thousand dollars, however the contractor would only receive four hundred and fifty thousand dollars and the

Associated General Contractors of Kansas, Inc.

P.O. Box 5253, 200 W. 33rd, Topeka, KS 66605-0253

(913) 266-4015

FAX: (913) 266-2561

*Senate Transportation & Tourism
2-3-92
Attachment #1*

remaining fifty thousand dollars would be retained. This would continue through the balance of the project and the contractor could eventually have between half a million to a million dollars being held at no interest.

This retainage represents money earned by the contractor, but unpaid until final completion of the project. This causes contractors to incur additional costs in the form of loan interest or the opportunity cost of forgone investment earnings.

Some agencies of the Federal Government, such as the VA and Corps of Engineers, do not include retainage provisions in construction contracts and many people argue that it should not be a part of other public works projects considering that the contractor must also provide a payment/performance bond to the public entity, which would come into play if the contractor were to go broke or, for other reasons, fail to complete the project satisfactorily. In Senate Bill 489 we do not propose the elimination of retainage, but we do propose additions and changes in the statutes regarding retainage on public works projects. Following are the four major provisions of the bill:

I. Retainage withheld from payments to contractors may not exceed 5% of the payment or 5% of the total contract.

II. On contracts over one million dollars (\$1,000,000), contractors may request that retained funds be placed in an interest-bearing escrow account in an approved financial institution as specified in the bill. The contractor would be responsible for establishing and paying any fees

associated with the account. The interest on the funds deposited in the account would be paid to the contractor as it is earned. This agreement would provide that the retained funds would be returned to the public entity in the event that the contractor has defaulted.

III. On contracts over one million dollars (\$1,000,000), after retainage has been withheld the contractor may request that approved securities, i.e. U.S. Treasury Bonds, Notes, Certificates of Deposits or bonds of the state of Kansas or political subdivisions, may be substituted for the retained monies. Substituted securities would have to equal or exceed the amount of the retained funds.

IV. If during the course of the project the contractor should default, the retained funds or substituted securities would revert to the public contracting entity.

These provisions are contained on pages 1 and 2 of the bill. Other sections of the bill are simply modifications to current statutes that would make them conform to the new language.

Members of the committee, this bill represents a significant statement of public policy for public works in Kansas. We sincerely believe that it is a good idea and, in the interest of fairness, one that we hope will be adopted by this committee and recommended to the Kansas Senate. Before we developed this proposal, we conducted a survey of other AGC chapters throughout the United States. As a result of this survey, we have information from AGC chapters in twenty different states that provide for the substitution of securities or the escrow concept we have suggested. In addition to that, I have attached to the testimony a one page article which indicates thirty one

states have similar provisions. I also have information from the Construction Financial Management Association and the Association of Leading Credit Risk Professionals that indicate the average profit before taxes for commercial building contractors is 2.6%, and for highway contractor 3.4%. The survey indicates average before tax net income for companies with ten million dollars in revenue is 2.1%. We think these indications of low profit margins plus the highly competitive nature of our industry more than justifies the five percent cap on retainage. Simple arithmetic indicates that if 5% of monies are held and a profit of less than 3% is being made, the construction industry is a pretty tough way to earn a living.

And once more, let me emphasize that once the pay request is approved, this money has been earned by and belongs to the contractor.

We respectfully request your favorable consideration of Senate Bill 489.

MAKING YOUR RETAINAGE DOLLARS WORK FOR YOU!

by Martin S. Bodner

For those contractors who work in the public sector, the government requirement for cash retainage or "retained percentages" poses two problems: minimizing the amount of money that your money earns and maximizing the impact on your tax liability.

Simply put, retainage is money that the government agency withholds from the contractor until completion and final acceptance of the project. Retainage is actually a method of withholding funds earned by the contractor in the performance of his work. Depending on the size of the contract, this amount can be quite significant and can have a bearing on earnings. In addition, administrative processing delays often result in losses of substantial income to the contractor and may even necessitate the borrowing of funds to cover costs.

However, recognizing the need for a better and fairer method of doing business together, 31 states now allow contractors to substitute approved securities in lieu of cash retainage. These securities are usually tax-free bonds issued in the state in which the contractor is working or U.S. Treasury Certificates - T-Bills, T-Notes, or T-Bonds.

Though the details vary from state to state, in general, the contractor must deposit (with a specified custodian) a sufficient quantity of marketable securities whose liquidation value is at least equivalent to the amount of cash retainage available. The government agency has control over the escrow account and the contractor receives the interest income generated by the investment. Final and full payment to the contractor is accomplished following the same procedures under customary retainage agreements.

Taking advantage of this concept gives the government agency "protection" while allowing the contractor to earn interest income and possible capital gains on otherwise dormant dollars. Your lending institution and bonding company will endorse this concept because you are building a portfolio of hard assets, with an emphasis on capital preservation.

As in other investments, your philosophy can vary from the conservative to the aggressive. For example, if you gear the maturity dates of your bonds to the completion date of the job, you eliminate market risk. You may also buy securities with somewhat extended maturities so that they may cover guarantee periods and may be transferred from one contract to another.

This second method will ultimately generate cash flow on the second and subsequent usage of the same bond.

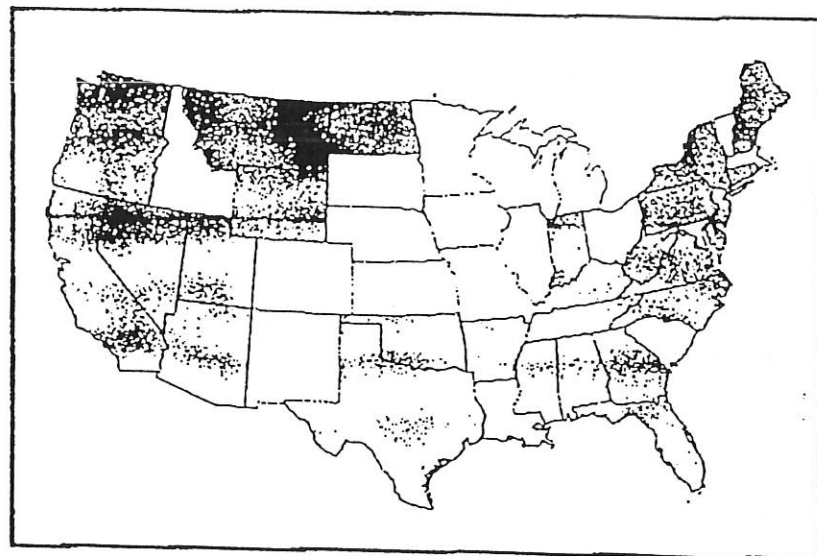
Finally, there are additional benefits to this approach above and beyond receiving interest income and the use of the retainage money on the second use of the same security. For example, from the contractor's point of view, the investment of retainage dollars may allow for tax strategies not previously available. And from the government agency's point of view, not only are new markets created for municipal bonds and school districts, but lower bids may result based on the anticipated earnings from the interest on these securities.

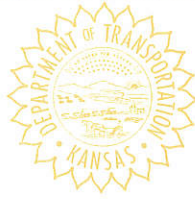
If your company is doing public works business in a state that does not allow for this retainage alternative, I strongly suggest that you lobby and work through your professional associations for such a provision. If your company is doing public works business in one of the 31 states listed below, I urge you to seriously consider this exciting and profitable alternative.

Martin S. Bodner is Vice President/Retainage Specialist for PaineWebber of Morristown, New Jersey and has been dealing with contractors in the public sector for ten years. Martin graduated from Northeastern University in 1962 and is active in a variety of professional organizations.

The 31 states that have approved this practice are:

Alabama	New Hampshire
Arizona	New Jersey
Arkansas	New York
California	North Carolina
Connecticut	North Dakota
Delaware	Oklahoma
Florida	Oregon
Georgia	Pennsylvania
Indiana	Rhode Island
Kentucky	Tennessee
Louisiana	Texas
Maine	Utah
Mississippi	Virginia
Montana	Washington
Nevada	West Virginia
	Wyoming





KANSAS DEPARTMENT OF TRANSPORTATION

E. Dean Carlson
Secretary of Transportation

Docking State Office Building
Topeka 66612-1568
(913) 296-3566
TTY (913) 296-3585
FAX (913) 296-1095

Bill Graves
Governor of Kansas

Testimony before the Senate Transportation Committee
Regarding SB 489
Construction Contract Payment Procedures
February 3, 1998

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to testify before you today regarding SB 489. I am Mike Lackey, Assistant Secretary and State Transportation Engineer, with the Kansas Department of Transportation.

We are in support of prompt payment to contractors. It has been our policy for years to get contractors paid promptly.

We support the five percent retainage provision. We typically retain five percent until the contract nears completion with a progressive reduction to \$500.00. We see no reason for government to hold dollars earned by private contractors.

We do not support the provisions authorizing escrow accounts because of its burden on the agency, and the following:

- 1) we pay promptly and reduce the retainage progressively;
- 2) we have not had complaints from our contractors; and
- 3) we have too many contracts to manage.

Type	New Annually	Valued at \$1 Million or Over
Construction	400	100
Design	20	10-15

SENATE TRANSPORTATION & TOURISM
COMMITTEE -DATE: 2-3-98
ATTACHMENT: 2

AIA Kansas

A Chapter of The American Institute of Architects

February 3, 1998

TO: Members of the Senate Transportation & Tourism Committee

FROM: Trudy Aron, Executive Director

RE: OPPOSITION TO SB 489



Good Morning, Mr. Chairman, and members of the Committee, I am Trudy Aron, executive director, of the American Institute of Architects in Kansas (AIA Kansas.) Thank you for the opportunity to address your committee today regarding our opposition to SB 489.

AIA Kansas is a state-wide association of architects and intern architects. Most of our 700 members work in over 100 private practice architectural firms designing a variety of project types for both public and private clients including justice facilities, schools, hospitals and other health facilities, industrial buildings, offices, recreational facilities, housing, and much more. The rest of our members work in industry, government and education where many manage the facilities of their employers and hire private practice firms to design new buildings and to renovate or remodel existing buildings.

SB 489 reduces, by half, the amount of money a public owner may withhold from a contractor to ensure the completion of a project; allows interest on the withheld funds; and allows the contractor to escrow securities in lieu of the owner retaining funds. We oppose these changes and believe the owner should make these decisions on a project by project basis.

The construction of a building involves many trades and, often, dozens of workers. For example, different firms will provide excavating, structural steel, concrete work, electrical, mechanical, interior framing, drywall, painting, etc. The firm who holds the contract with the public entity is responsible for delivering a completed project to the owner at a specified price and time. This firm is responsible for coordinating all the work and making sure it is completed.

One of the most frustrating times for owners and architects is at the end of a construction project when most, but not all, of the work has been done. The owner is anxious to occupy or use the project and the contractor is anxious to move on to with other work. The contractor says the project is complete but when the owner and architect walk through the project, many items have not been completed.

The withholding of funds, in many cases, becomes the owner's only leverage to get the contractor to finish the work. We believe the decision on what percentage of funds is retained should remain with the owner. The current language gives the owner the option to reduce the amount withheld depending on many factors, including the type of project and the performance relationship the contractor has with the owner. In addition, the owner may, at any time during the project, reduce the amount withheld or return the retained funds before completion of the project.

We also believe the retained funds should be from the project and not security from the contractor. We believe the owner should continue to control these funds until the project is completed.

Thank you for allowing us to testify in opposition to SB 489. We believe it is in the best interest of the public to allow the owner to decide the amount of funds to be withheld for the project and if interest or securities will be allowed. I will be happy to answer any questions you may have.

700 SW Jackson, Suite 209
Topeka, Kansas 66603-3757
Telephone: 913-357-5308
800-444-9853
Facsimile: 913-357-6450


SENATE TRANSPORTATION & TOURISM
COMMITTEE -DATE: 2-3-98
ATTACHMENT: # 3



**League
of Kansas
Municipalities**

PUBLISHERS OF KANSAS GOVERNMENT JOURNAL 300 S.W. 8TH TOPEKA, KS 66603-3896 (785) 354-9565 FAX (785) 354-4186

TO: Senate Transportation and Tourism Committee

FROM:  Chris McKenzie, Executive Director

DATE: February 2, 1998

SUBJECT: Opposition to SB 489

Thank you for the opportunity to appear today on behalf of the 530 member cities of the League of Kansas Municipalities in opposition to SB 489. Our opposition is based on the following principles:

- ① **Local Control and Home Rule.** SB 489 would impose limitations on the use of retainage provisions in local public works contracts, including those financed solely with local tax funds. Municipal elected officials may desire to employ a retainage provision in a contract which exceeds the 5% cap in subsection (a) of New Section 1 based on local circumstances that they determine justify the amount. For example, a contract with a smaller face amount may actually justify a higher percentage in order to ensure completion of the project in a timely way.
- ② **Federally Funded Projects.** I asked the Division of Community Development of KDOCH to evaluate the impact of this bill on the Community Development Block Grant (CDBG) Program administered by that agency. The director of the Division, Mary Faye LaFaver, advised me that the program guidelines for that program recommend a 10% retainage. She further advised that in her judgment that a limitation of a 5% retainage would put many cities and counties which receive such grants "in a box" because it is not uncommon for a contractor to move on to a large job before finishing a small CDBG project. She indicated a 10% retainage may be necessary to retain the contractor's interest long enough to finish the project. We are still researching whether any other federally funded or state funded projects "require" a larger than 5% retainage amount.
- ③ **Escrow Provisions Unworkable.** Subsection (b) of New Section 1 contains a complicated security substitution provision for contracts of \$1 million or more which raises a number of questions.

First, under current law, unless the parties otherwise agree to a retainage amount, contracts are let for a fixed amount with both the city and the contractor agreeing on

SENATE TRANSPORTATION & TOURISM
COMMITTEE -DATE: 2-3-98
ATTACHMENT: # 4

4-1

that amount. While all money has a time value, the interest earnings on any unpaid amount accrues to the benefit of the taxpayers, allowing other projects to be financed or taxes to be kept lower.

Second, certain federal grant programs (such as the CDBG program) specifically prohibit the establishment of an escrow amount in which federal funds could be deposited. This could lead to confusion if federal and state funds have to be treated differently.

Third, for larger cities which have many contracts in place at any point in time, the creation of separate escrow accounts for each project would be a bureaucratic nightmare, raising public costs to taxpayers.

Fourth, the wording of subsection (c) on page 2 is sufficiently vague to give rise to all kinds of questions and legal maneuvering. For example, on line 15 it says, "The value of the securities substituted must be at least equal to the amount of the funds retained." Does this refer to the principal amount of the security or the value at maturity? Might it refer to the market value of the security, which can fluctuate on a regular basis?

Fifth, the city is required in lines 23-24 to return the substituted securities to the contractor "with any interest that has accumulated." Does a federal security which has a fluctuating market value accrue interest if it is not sold but merely exchanged?

Finally, will title to the securities placed in escrow be transferred to the city, and how would the securities be partitioned in the event, mentioned beginning in line 24 on page 2, the city made a claim against the contractor for nonperformance in an amount less than the total amount? Can the city sell the securities on the open market on the day its partitions the amount? What if the market improves a few days later? Would the city owe the contractor anything? These are among the many questions this subsection raises.

RECOMMENDATION: For all of the above reasons, we urge you not to support SB 489.

Thank you.



KANSAS
ASSOCIATION OF
COUNTIES

TESTIMONY
Before the Senate Transportation and Tourism Committee
February 3, 1998

Senator Vidricksen, Members of the Committee, thank you for allowing me to appear before you today. I am Judy Moler, Legislative Services Director and General Counsel for the Kansas Association of Counties.

The Kansas Association of Counties is here today to register our opposition to the passage of SB 489. This bill is violative of local control and the statutory home rule afforded counties. County commissioners are elected to be the decision makers at the local level and to make the best decisions at the local level for their constituency.

In addition, after checking with several private companies, 10% retainage is the usual rate used by those in the business world. Why would we want those spending the taxpayer's money to use a lesser amount?

I have attached a letter from the Public Works Director of Washington County indicating his opposition to the bill.

Kansas Association of Counties, an instrumentality of member counties under K.S.A. 19-2690, provides legislative representation, educational and technical services and a wide range of informational services to its member counties. Inquiries concerning this testimony should be directed to the KAC by calling (785) 233-2271

700 SW Jackson
Suite 805
Topeka KS 66603
785•233•2271
Fax 785•233•4830
email kac@ink.org

SENATE TRANSPORTATION & TOURISM
COMMITTEE -DATE: 2-3-98
ATTACHMENT: # 5

**Washington
County Public
Works
Department**

Washington County Public
Works Department
P.O. Box 277
1661 Rainbow Road
Washington, KS 66968

Phone: 785-325-2318
FAX: 785-325-2383
email:

Facsimile

To: RANDY ALLEN, EXEC DIR, KAC
@Fax: 785-233-4830
From: GLENN LARSON
Date: Monday, February 2, 1998 @ 3:32PM
Re: SB 489
Pages: 1, including this one

I BELIEVE THE BILL AS PROPOSED HAS A LOWER EFFECTIVE LIMIT FOR CONTRACTS OF \$1,000,000. AS SUCH, CHANGING THE WITHHOLDING TO 5% IS WORKABLE BUT THE PROVISION FOR PLACING THE WITHHOLDING IN AN INTEREST BEARING ESCROW ACCOUNT PLACES AN ADMINISTRATIVE BURDEN ON THE COUNTY. ESPECIALLY IF THE WITHHOLDING WERE 5% OF SOME LAST PAYMENT IT MIGHT BE ONLY A FEW THOUSAND DOLLARS. SEEMS A LOT OF WORK FOR NOT MUCH GAIN. BEST THAT THE CONTRACTOR GET HIS WORK DONE PROMPTLY SO HE CAN GET HIS FINAL PAYMENT. THAT IS THE PURPOSE OF WITHHOLDING IN THE FIRST PLACE.



GLENN LARSON
ADMINISTRATOR PUBLIC WORKS

TESTIMONY REGARDING SENATE BILL 489
SENATE COMMITTEE ON TRANSPORTATION AND TOURISM
February 3, 1998, 9:05 a.m., Room 254-E

Presented by Shirley A. Moses
Director of Accounts and Reports

Mr. Chairman, Members of the Committee:

Thank you, Mr Chairman, for allowing me the opportunity to provide information regarding Senate Bill 489. I am testifying this morning in opposition to certain provisions of Senate Bill 489.

New Section 1 of Senate Bill 489 allows for construction contracts of \$1,000,000 or more, the contractor may request the retained funds be placed in an interest bearing escrow account not to exceed five percent of any partial or complete payment and not to exceed five percent of the entire contract. Furthermore, provisions allow these funds to be placed in a state or national bank, federally chartered savings and loan association, or federally chartered savings bank with offices located in Kansas.

Senate Bill 489 has the effect of taking away the state's leverage to get a contractor to finish a project because the retainage could be placed in an interest bearing account that is eventually turned over to the contractor. This has the potential of reducing the contractor's incentive to finish the project in that case.

In addition, the state moneys would be taken out of the state system and be maintained in private banks. Separate private accounts would need to be established and maintained for these state funds. The bill allows the contractor to make this choice. Theoretically, there could be a separate private account for each construction contract exceeding \$1,000,000. I believe this represents bad public policy. The retainage amounts should be maintained within the state system and earn interest for the state general fund.

Thank you for the opportunity to appear before the Committee today. I would be happy to answer any questions the Committee may have.

SENATE TRANSPORTATION & TOURISM
COMMITTEE -DATE: 2-3-98
ATTACHMENT: # 6

SB 489 - CHANGING RETAINAGE ON CONSTRUCTION CONTRACTS.

Testimony for the TRANSPORTATION & TOURISM COMMITTEE

by ^{TAA} Thaine Hoffman, Director of the Division of Architectural Services

February 3, 1998

This bill would make two changes:

- It would reduce the retainage on construction contracts from 10% down to 5%.
- It would allow contractors to receive interest on the funds that are being retained.

Both of these moves will reduce the ability of the State to get projects completed in a proper and timely manner.

Projects need to be ready for occupancy on schedule. Often it is necessary to move in soon after the scheduled completion date. For example, a university dormitory must be ready for the next semester. The rooms are already rented and there are no alternatives. Retainage and liquidated damages motivate the contractor to meet the schedule and finish up the work.

After the building is substantially complete, there are usually items still to be completed or corrected. It is disruptive for the occupants that the building still has incomplete items, yet contractors often don't finish up the last little items. Until recently, the security system was not completed on a building that was occupied well over a year ago. In another case, a building was to be completed over a year ago, it is occupied but several items still remain to be completed. After we occupy the building, retainage is our only leverage.

This bill hurts in several ways. First, it cuts the retainage in half so there is less pressure on the contractor to finish the work. Second, it indicates that the retainage is to be reduced to only cover the value of the work remaining. This means that the contractor can make more by going to the next project than finishing this one. What motivation is there to do \$10,000 of work when only \$10,000 is retained, when he can be working on large projects that generate a large profit. Third, if the contractor is earning interest on the retainage, there is little motivation for him to complete the work so he can get the retainage released. If this is passed in this form, there is little reason to hold retainage at all. It simple will no longer be a motivation.

SENATE TRANSPORTATION & TOURISM
COMMITTEE -DATE: 2-3-98
ATTACHMENT: # 7

Lets look at who gets the interest. Now, the contractor figures interest in his bid. This probably isn't a line item, but is part of the overhead. We are thus paying for the interest during construction. However, A&R earns interest on the retainage that we are holding. That offsets the interest we are paying in the contract, although it doesn't go back in the same pocket. If the contractor doesn't finish on time, he is loosing interest that he didn't expect to loose so gets concerned about finishing the work so he can get it released.

Now lets look at the new system. The contractor knows he will be drawing interest on the retainage so he may not include that in his overhead, thus we may get a slightly better bid, however, A&R does not earn interest on the retainage so we haven't gained anything. However, after the completion date, the contractor is earning a good return on his retainage so why hurry to get the job completed.

Another thought is that the contractor can actually make money on this because they hold retainage on major subcontractors. Are they going to share the interest with them?

Another concern in addition to getting the work done on time is our ability to get what we are paying for. We have one project where the boilers were damaged during construction. They have been patched but we know that in the long run, these boilers will require more maintenance than boilers that had not been damaged. The contractor does not care to replace them. Our only power is to withhold retainage. If he is making a good return on the retainage, we can only give in or go to court on an item that may be too small to justify that.

In addition to reducing our power to get the work completed, this will cost the state to administer. Even though the bill indicates that the contractor must pay for setting up the accounts, someone must keep track of this and be responsible for it. I don't have an idea of the cost, but it will take some additional time at our level and at the agency level, and I would guess much additional time for A&R. Shirley Moses, the Director of A&R is here to address that problem.

For these reasons, we opposed the changes.

Lets face it. There is only one reason for retainage. That is to motivate the contractor to complete the work as contracted. If a contractor completes the work on schedule, he receive his retainage quickly. If the contractor is not getting the work done properly and on schedule, we need all the power we have to motivate the contractor.