Department of Legislative Services

Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 870 (Senator Mathias, *et al.*)
Finance

Prevailing Wage - Tax Increment Financing Developments - Application

This bill requires that prevailing wages be paid for the construction of a structure or work, as defined by the bill, that is located in a tax increment financing (TIF) district and is built using proceeds from local government bonds authorized in statute for use in those districts. The bill does not apply if the bond issued by the local government is for less than $500,000.

The bill takes effect July 1, 2017, and applies only to contracts executed on or after that date.

Fiscal Summary

State Effect: As the number of projects expected to be affected by the bill in any given year is minimal, the Department of Labor, Licensing, and Regulation (DLLR) can handle any additional enforcement responsibilities with existing budgeted resources, as discussed below. No effect on revenues.

Local Effect: The total cost of future construction projects in TIF districts funded by local bonds may increase by between 2% and 5%, but the cost of individual projects may vary. Local capital expenditures likely are not affected, but the increased costs may mean fewer projects receive funding or some projects are delayed. No effect on revenues.

Small Business Effect: Minimal.

Analysis

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

Tax Increment Financing: All counties and municipalities are authorized to utilize tax increment financing under Title 12, Subtitle 2 of the Economic Development Article (the Tax Increment Financing Act). In Baltimore City, the authority to use tax increment financing is provided in the city charter. Counties and municipalities (including Baltimore City) may issue bonds to finance the development of an industrial, commercial, or residential area. Generally, the bond proceeds may only be used (1) to buy, lease, condemn, or otherwise acquire property or an interest in property in the development district, a Regional Institution Strategic Enterprise (RISE) zone, or a sustainable community; or needed for a right-of-way or other easement to or from the development district, a RISE zone, or a sustainable community; (2) for site removal; (3) for surveys and studies; (4) to relocate businesses or residents; (5) to install utilities, construct parks and playgrounds, and for other needed improvements including roads to, from, or in the development district; parking; and lighting; (6) to construct or rehabilitate buildings for a governmental purpose or use; (7) for reserves or capitalized interest; (8) for necessary costs to issue bonds; and (9) to pay the principal of and interest on loans, advances, or indebtedness that a political subdivision incurs for a specified purpose.

Bonds issued for use in a sustainable community or a RISE zone have different use criteria.

The "original base" for a TIF district means the assessable base of the district:

- as of January 1 of the year preceding the effective date of the resolution creating the district; or
- if applicable, the original base for a brownfields site as determined by resolution of the political subdivision.

Background:

Tax Increment Financing in Maryland: Tax increment financing is a public financing method that uses future gains in tax revenues to finance current improvements. The increase in the property tax revenue generated by new commercial development in a specific area, the TIF district, pays for bonds issued to finance site improvements, infrastructure, and other project costs located on public property. In a TIF district, the local government "freezes" the existing property tax base and uses the property tax revenue from this base as it would normally use such funds. The difference between the current tax base and the frozen base in each future year is termed the incremental valuation. The local government apportions the property tax revenue on the incremental valuation to a special account for certain purposes including to pay debt service on the bonds and to potentially pay for additional public expenditures in the TIF district. The TIF district ceases to exist upon the retirement of the bonds, and after that time, all property tax revenue may be appropriated by normal means.

According to the State Department of Assessments and Taxation, seven jurisdictions – Baltimore City and Anne Arundel, Baltimore, Harford, Howard, Prince George's, and Wicomico counties – have seen an increase in the assessable base in fiscal 2016 over the year the TIF districts were established. **Exhibit 1** shows the number of TIF districts by jurisdiction and the estimated tax increment for the seven jurisdictions with TIF districts as of March 2015.

Exhibit 1
TIF Districts and Combined Values by Jurisdiction

County	Number of Districts	Combined Value ($ in Millions)
Allegany	0	
Anne Arundel	7	$4,708.3
Baltimore City	9	475.0
Baltimore	1	30.8
Calvert	0	
Caroline	0	
Carroll	0	
Cecil	0	
Charles	0	
Dorchester	0	
Frederick	0	
Garrett	0	
Harford	1	59.5
Howard	1	6.3
Kent	0	
Montgomery	0	
Prince George's	7	1,441.9
Queen Anne's	0	
St. Mary's	0	
Somerset	0	
Talbot	0	
Washington	0	
Wicomico	2	8.9
Worcester	0	
Total	**28**	**$6,730.6**

TIF: tax increment financing

Source: State Department of Assessments and Taxation; Baltimore City; Anne Arundel and Prince George's counties; Department of Legislative Services

State Expenditures: As noted in the appendix, the number of prevailing wage projects subject to enforcement by DLLR has increased dramatically in recent years, so that any meaningful increase in the number of projects requires additional enforcement staff and other resources. However, given that there are fewer than 30 TIF projects currently in the State and that the bill applies only to contracts executed on or after the effective date of the bill, the Department of Legislative Services anticipates that, at most, only a handful of projects are affected in any given year. Therefore, no additional enforcement resources are needed.

Additional Information

Prior Introductions: None.

Cross File: HB 466 (Delegate McCray, *et al.*) - Economic Matters.

Information Source(s): Maryland Economic Development Corporation; Department of Commerce; Baltimore City; Anne Arundel and Prince George's counties; Maryland Association of Counties; Department of Budget and Management; Department of General Services; Department of Health and Mental Hygiene; Department of Housing and Community Development; Department of Labor, Licensing, and Regulation; Maryland Department of Transportation; State Department of Assessments and Taxation; Department of Legislative Services

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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, or $250 per laborer per day if the employer knew or reasonably should have known of the obligation to pay 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 almost all public school construction projects in the State required to pay the prevailing wage, subject to the $500,000 contract value threshold.

The number of prevailing wage projects has risen dramatically in recent years. DLLR advises that its prevailing wage unit currently monitors about 2,300 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 250 projects at any given time; there are currently five filled positions.

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 which is 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.