

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 509

Prompt Payment for Construction Services

**SPONSOR(S):** Reagan

**TIED BILLS:**

**IDEN./SIM. BILLS:** SB 632

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REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) <u>Governmental Operations Committee</u>	<u>4 Y, 0 N</u>	<u>Luppert</u>	<u>Everhart</u>
2) <u>Local Government Council</u>	<u></u>	<u></u>	<u></u>
3) <u>State Administration Appropriations Committee</u>	<u></u>	<u></u>	<u></u>
4) <u>State Administration Council</u>	<u></u>	<u></u>	<u></u>
5) <u></u>	<u></u>	<u></u>	<u></u>

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### SUMMARY ANALYSIS

This bill affects state and local governments, contractors, subcontractors, sub-subcontractors, materialmen, and suppliers.

The bill reduces time frames during which contractors and subcontractors must issue payments to their subcontractors and suppliers. It also restricts the percentage state and local governments may withhold from each payment to contractors during construction. Upon substantial completion of construction projects, the bill requires state and local governments to develop a list of items (a punch list) for final acceptance of construction services purchased.

The fiscal cost to state and local governments is indeterminate, though the estimated cost is minimal. The economic impact to private construction contractors and subcontractors is indeterminate, though it is estimated to be positive on subcontractors. (see Fiscal Analysis and Economic Impact Statement)

The bill has an effective date of October 1, 2005.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. HOUSE PRINCIPLES ANALYSIS:

Provide limited government:

The bill reduces time frames during which contractors and subcontractors must issue payments to their subcontractors and suppliers. It also restricts the percentage state and local governments are able to withhold from each payment for construction services.

#### B. EFFECT OF PROPOSED CHANGES:

##### **Background**

##### ***Florida Prompt Payment Act***

Part VII of ch. 218, F.S., known as the "Florida Prompt Payment Act", only relates to local governments and was enacted in 1989. The Florida Prompt Payment Act serves to ensure that "payment for all purchases by local governmental entities be made in a timely manner." The purpose of the act is to provide for:

- prompt payments by local governmental entities and their institutions and agencies.
- interest on late payments made by local governmental entities and their institutions and agencies
- a dispute resolution process for payment of obligations.

"Local governmental entity" means a county or municipal government, school board, school district, authority, special taxing district, other political subdivisions, or any office, board, bureau, commission, department, branch, division, or institution thereof or any project supported by county or municipal funds.

There is no current statute that pertains to the prompt payment of construction services for state governments.

##### Timely payment for construction services

Current law allots 15 days for both contractors and subcontractors to pay downstream to their subcontractors and suppliers once they have received payment from local governments.

##### ***Retainage***

Retainage is a common construction practice and refers to a certain percentage of payment withheld by the project owner (i.e. state and local governments) from the general contractor and, in turn, the general contractor from the subcontractor to ensure satisfactory completion of the project. Payments for construction services are usually made incrementally, with a certain percentage withheld.

Current statute does not provide for a cap on the amount of retainage state or local governments may withhold from each payment for construction services. The standard amount of retainage throughout the construction industry is 10 percent.<sup>1</sup>

The Office of Program Policy Analysis and Governmental Accountability (OPPAGA), an office of the Florida Legislature, stated in a December 2000 report:<sup>2</sup>

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<sup>1</sup> Department of Management Services Substantive Bill Analysis

<sup>2</sup> OPPAGA Special Review: Inflexibility in Contracting and Retainage Practices Could Hurt Construction Industry, Report No. 00-26, December 2000.

- “Florida’s subcontractors, who felt that retainage often creates undue financial hardships, asked the 2000 Legislature to consider limiting the allowable percentage of compensation that could be retained. In response, the Legislature requested OPPAGA to evaluate retainage.”
- “Proponents of this practice claim it is necessary as leverage to assure timely completion of construction projects. Opponents of retainage claim the time period associated with major construction projects can be a lengthy process, leaving subcontractors who perform work early on the project waiting extended periods to receive retainage payments.”

## **Effect of Bill**

This bill amends the title of s. 218.70, F.S., to rename the section the “Local Government Prompt Payment Act.” This act applies strictly to local governments. The bill creates s. 255.0705, F.S., and names this section the “Florida Prompt Payment Act.” This act applies strictly to state governments.

### ***Timely payment for construction services***

The bill addresses the time period within which contractors and subcontractors must remit payment to their subcontractors and suppliers for construction services once the contractor has received payment from a state or local government for construction services. The bill reduces the period from 15 days to 10 days for contractors and from 15 to 7 days for subcontractors, in which they must receive payment. It also requires state governments to request payment from the CFO no more than 20 days after receiving a payment request.

Payments for construction services not made within the established time period are subject to an interest rate established by the CFO in s. 55.03(1), F.S. The bill requires that after July 1, 2006, such payments shall bear interest at the rate of 1 percent per month.<sup>3</sup>

### ***Development of final punch list***

The bill requires state and local governments to devise a list (known as a “punch list”) required to render the construction services purchased “complete, satisfactory, and acceptable”. Timing for the development of the list is as follows:

- For construction projects having an estimated cost of \$10 million or less, 30 calendar days upon reaching substantial completion.
- For construction projects having an estimated cost of \$10 million or more, 30 calendar days, unless otherwise extended by contract not to exceed 60 calendar days, upon reaching substantial completion.

The bill refers to the term “substantial completion” as, “ defined in the contract, or, if not defined in the contract, upon reaching beneficial occupancy or use.”

Once all items on the list have been completed, the contractor may submit a payment request for any remaining retainage being withheld by the state or local governments. However, if the contractor has either failed to cooperate in the development of the list, or failed to perform his or her contractual obligations, the state or local government is not required to make payment or process retainage.

### ***Retainage***

The bill creates a retainage cap providing that until 50 percent of the contract value has been earned, the state or local governments may not withhold more than 10 percent from payments as retainage. For the last half of the project, the amount of retainage withheld may not exceed 5 percent, unless good cause is given in writing to a subcontractor on a case-by-case basis. Municipalities with a population of 25,000 or fewer, and counties with a population of 100,000 or fewer, are able to withhold retainage up to 10 percent until the project is completed and accepted by the local government.

<sup>3</sup> See Fiscal Analysis and Economic Impact Statement

After half of the project is completed, the contractor may submit a payment request for up to one-half of the retainage being held by the state or local government. Once the state or local government makes payment to the contractor, the contractor must remit payment in a timely fashion to subcontractors and suppliers. "Timely", as used in the bill, is not defined.

Claimants filing suit for recovery of retainage must take action within 1 year after the "performance of the labor or completion of delivery of the materials or supplies."

Retainage cannot be held to cover insurance premiums under an owner or contractor controlled insurance program, and final payment of retainage may not be delayed pending performance of a final audit by the state, local government, or contractor's insurance provider.

### ***Exemptions from Retainage caps***

1. Any amounts that are subject of a good-faith dispute, an action brought under s. 255.05, or subject of a claim or demand.
2. Federally funded projects
3. Construction projects with a total cost of \$200,000 or less.

### ***Current construction contracts***

The provisions of this bill do not apply to any existing construction contracts, a contract pending approval, or any contract advertised for bid on or before October 1, 2005.

## **C. SECTION DIRECTORY:**

Section 1 amends s. 218.70 F.S., to rename the short title the "Local Government Prompt Payment Act".

Section 2 revises s. 218.72 (2), (6), (7), and (10), F.S., to amend definitions of "local governmental entity", "vendor", "construction services", and to add a definition for "contractor".

Section 3 amends s 218.735 (6), F.S., to reduce time period contractors and subcontractors must remit payment, and creates (7) (a) – (h) to establish requirements for a final punch list, and creates (8) (a) – (i) establishing retainage cap and requirements/restrictions applying thereto.

Section 4 creates s. 255.0705, F.S., to provide a popular name; "Florida Prompt Payment Act".

Section 5 amends s. 255.071(2) and (3) F.S., to add time limitations established in s. 255.073(3), F.S.

Section 6 creates s. 255.072(1) - (6), F.S., to provide definitions for "agent", "construction services", "contractor", "payment request", "public entity", and "purchase".

Section 7 creates s. 255.073(1) – (4), F.S., to reduce the time period public entities must remit payment; addresses interest on late payments.

Section 8 creates s. 255.074(1) – (3), F.S., to provide procedures for calculation of payment due dates.

Section 9 creates s. 255.075, F.S., to authorize collection of late payment interest charge under s. 255.073(4), F.S.

Section 10 creates s. 255.076, F.S., to deem court costs and attorney's fees applicable in an action to recover.

Section 11 creates s. 255.077(1) – (8), F.S., to establish requirements for a final punch list for public entities.

Section 12 creates s. 255.078(1) – (9), F.S., to establish a retainage cap for public entities and requirements/restrictions applying thereto.

Section 13 amends s. 255.05(2) (a) , F.S., to add claimants not in privity must specify amount claimed for retainage. (10) adds time period and requirements for claimants filing suit against contractors.

Section 14 requires legal or equitable actions be governed by applicable provisions of s 255.05(10)

Section 15 states that neither the amendments nor created statutes in this act apply to existing contracts. Section 16 provides for an effective date of October 1, 2005.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

### A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None

2. Expenditures:

The bill could have a fiscal impact on state government. The expenditures could occur when filing suit to enforce the provisions of this bill<sup>4</sup>, or from interest payments required when state governments do not act in accordance with new timelines for payment of construction services.<sup>5</sup> Since the number of instances state governments would fail to meet the established payment timelines cannot be predicted, neither can the amount of interest that would accumulate. However, because the bill establishes a new rate of interest for late payment of construction services after July 1, 2006, DFS has estimated \$22,000 for modifying business documents, testing and changing programs, as well as the total work hours necessary for completing these changes.<sup>6</sup> The state government may also incur expenditure in the opportunity cost lost when conforming to the reduced payment timelines. However, that value is not measurable.<sup>7</sup>

### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None

2. Expenditures:

The bill could have a fiscal impact on local governments. The expenditures could occur when filing suit to enforce the provisions of this bill<sup>8</sup>, or from interest payments required when local governments do not act in accordance with new timelines for payment of construction services.<sup>9</sup> Since the number of instances local governments would fail to meet the established payment timelines cannot be predicted, neither can the amount of interest that would accumulate. However, because the bill establishes a new rate of interest for late payment of construction services after July 1, 2006, DFS has estimated \$22,000 for modifying business documents, testing and changing programs, as well as the total work hours necessary for completing these changes.<sup>10</sup> The local governments may also incur expenditure in the opportunity cost lost when conforming to the reduced payment timelines. However, that value is not measurable.<sup>11</sup>

### C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

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<sup>4</sup> Department of Management Services 2004 Substantive Bill Analysis

<sup>5</sup> Department of Management Services 2004 Substantive Bill Analysis

<sup>6</sup> Department of Financial Services, 2004 Agency Analysis

<sup>7</sup> State Administration Appropriations Committee 2005

<sup>8</sup> Department of Management Services 2004 Substantive Bill Analysis

<sup>9</sup> Department of Management Services 2004 Substantive Bill Analysis

<sup>10</sup> Department of Financial Services, 2004 Agency Analysis

<sup>11</sup> State Administration Appropriations Committee 2005

The bill may result in more timely payments to contractors, subcontractors, and suppliers who provide services or supplies in the construction of public projects.

D. FISCAL COMMENTS:

None

### III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

The bill requires municipalities or counties to conform to prompt payment provisions regarding purchases for certain construction services.

2. Other:

None

B. RULE-MAKING AUTHORITY:

Not applicable

C. DRAFTING ISSUES OR OTHER COMMENTS:

The American Subcontractors Association of Florida<sup>12</sup> has stated that they believe the current system of holding 10 percent retainage for an indefinite period of time is an outdated practice that strains relationships between the parties to a project, raises bids, and is often used in lieu of best management practices. Using money that is rightfully due to a party who has fully performed in order to guarantee the work of another party who failed to satisfactorily perform is harmful to the industry as a whole and does not promote completion of projects in a timely and successful manner.

The Florida Department of Management Services states:<sup>13</sup>

- the contractor will have no incentive to complete any punch list items when they know that the State must pay them anyway as amended under the provisions of s. 255.072 – 255.076 F.S. The public interest will have no leverage, and contractors may find it to be more cost effective to give up the 5 percent retainage than to go back and correct extensive punch list items
- Many projects involve a contracted agent such as an architect or construction manager to verify that the labor, services or materials have been provided as billed. This and the internal accounting controls such as Chief Financial Officers require a reasonable amount of time to assure the public's interest by the legislature.

The Florida Surety Association<sup>14</sup> raised some concerns with HB 509 in some of the provisions dealing with s 255.05, but the FSA is confident these concerns can be addressed.

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<sup>12</sup> Deborah E. Lawson, Executive Director

<sup>13</sup> Department of Management Services Substantive Bill Analysis

<sup>14</sup> Rick Watson, Richard Watson & Associates, Inc.

#### IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES