

GENERAL ASSEMBLY OF NORTH CAROLINA



Session 2009

Legislative Fiscal Note

BILL NUMBER: House Bill 1035 (First Edition)

SHORT TITLE: UNC Performance & Payment Bond Modification.

SPONSOR(S): Representatives Yongue, McLawhorn, Glazier, and Goforth

FISCAL IMPACT

Yes (X) No ( ) No Estimate Available ( )

FY 2009-10 FY 2010-11 FY 2011-12 FY 2012-13 FY 2013-14

REVENUES

EXPENDITURES See the Assumptions and Methodology Section

POSITIONS (cumulative):

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: University of North Carolina System

EFFECTIVE DATE: This act becomes effective July 1, 2009, and applies to construction contracts awarded on or after that date.

BILL SUMMARY:

April 2, 2009

H 1035. UNC PERFORMANCE & PAYMENT BOND MODIFICATION. Filed 4/2/09. TO INCREASE THE PERFORMANCE AND PAYMENT BONDING REQUIREMENT FOR CONSTRUCTION PROJECT CONTRACTS AWARDED BY THE UNIVERSITY OF NORTH CAROLINA THAT EXCEED FIVE HUNDRED THOUSAND DOLLARS.

Amends GS 44A-26 as the title indicates. Provides that the increase in the performance and bonding requirement applies to the University of North Carolina and its constituent institutions. Effective July 1, 2009, and applies to construction contracts awarded on or after that date

Source: Bill Digest H.B. 1035 (04/02/0200).

ASSUMPTIONS AND METHODOLOGY: House Bill 1035 amends G.S. 44A-26 to raise the floor for eligible university construction contracts that require performance and payment bonds.

Under current law, all State construction contracts that are greater than \$300,000 must have a performance or payment bond supplied by the general contractor or construction manager. These

bonds are purchased from third party surety firms and can cost from 1.5% to 3% of the construction contract cost. When bidding for a project, the builder will often include the cost of bonding in the bid.

House Bill 1035 lifts the \$300,000 floor to \$500,000 for University of North Carolina System (UNC System) projects. As a result, construction contracts that cost between \$300,000 and \$500,000 will no longer require performance or payment bonds.

**Fiscal Impact – No Bonding Costs for Projects between \$300,000 and \$500,000**

By eliminating the bonding requirement for projects between \$300,000 and \$500,000, the cost of purchasing bonds is eliminated from the contract. For the purpose of determining future cost savings from eliminating bonding costs from these projects, this analysis contains the following assumptions:

- In future years, the UNC System will continue to let affected construction contracts at levels consistent with contracts let since FY 2001-02;
- The average number of UNC System contracts between \$300,000 and \$500,000 per year since FY 2001-02 is 24;
- The average aggregate dollar amount in UNC System contracts between \$300,000 and \$500,000 per year since FY 2001-02 is \$7,618,614;
- Since FY 2006-07, the average annual percentage of the aggregate dollar amount in UNC System contracts between \$300,000 and \$500,000 funded with General Fund monies is 97%;
- For each of the next five years, the UNC System will let 24 contracts per year at a total dollar value of \$7,618,614 per year under current law;
- For each of the next five years, the General Fund will back 97% anticipated contract amounts; and
- Given the small size of each construction contract, the cost to bond these projects would be in the range of 2% to 3% of the contract cost.

	<b>FY 2009-10</b>	<b>FY 2010-11</b>	<b>FY 2011-12</b>	<b>FY 2012-13</b>	<b>FY 2013-14</b>
Anticipated Cost – Current Law	\$7,618,614	\$7,618,614	\$7,618,614	\$7,618,614	\$7,618,614
General Fund Percentage	97%	97%	97%	97%	97%
Anticipated General Fund Contract Cost	\$7,390,055	\$7,390,055	\$7,390,055	\$7,390,055	\$7,390,055
Percent of Contract Cost for Bonding	2%-3%	2%-3%	2%-3%	2%-3%	2%-3%
General Fund Cost Savings from Eliminating Bond Requirements	<b>-\$147,801 to -\$221,702</b>	<b>-\$147,801 to -\$221,702</b>	<b>-\$147,801 to -\$221,702</b>	<b>-\$147,801 to -\$221,702</b>	<b>-\$147,801 to -\$221,702</b>

**The State can expect to save between \$147,801 and \$221,702 per year in the General Fund.**

### **Fiscal Impact – Increased market for publicly bid UNC System Projects**

By eliminating the performance and payment bonding for UNC System construction contracts between \$300,000 and \$500,000, more contractors will qualify to bid for construction projects.

As with any insurance, contractors must qualify for bonding with a surety firm. Many small contractors struggle to secure the necessary bonding to bid for State construction projects. By eliminating the requirement for contracts costing between \$300,000 and \$500,000, these small contractors would now be eligible to bid for work.

An expanded bidding market for contracts affected by this bill should push the price down. Without more data on the size of the expanded contractor market and the anticipated impact to bid prices, a fiscal impact cannot be determined.

**The State could expect a cost savings on bid prices from an expanded contractor market, but a fiscal impact cannot be determined at this time.**

### **Fiscal Impact – Increased risk of non-performance on UNC System Projects**

Expanding the contractor market increases the risk of awarding contracts to builders that cannot complete the contract or poorly perform their obligations. Under current law, some contractors cannot bid for projects because no surety firm will bond their work for a reasonable fee. These contractors would be eligible to bid under this bill.

In addition to contractors that would not otherwise qualify for bonding, the current economic environment is placing significant pressure on the commercial construction industry in North Carolina. Currently, there is an increased risk of contractors going out of business, leaving owners with the responsibility of competing projects.

Without performance bonds, the State will bear the risk of accomplishing any incomplete projects.

The risk is minimized by the small size of the project in question and the relatively small aggregate dollar amount of contracts. The annual total cost of anticipated contracts is \$7,618.614 out of a State construction program that currently totals \$2.8 billion.

In addition, the State has not invoked the bonds for any of the 168 UNC System contracts let since FY 2001-02 that were reviewed for this analysis.

The State faces the risk of a minimal cost increase to UNC System construction contracts between \$300,000 and \$500,000 for non-performance from non-bonded contractors. The UNC System does not have a history of exercising currently required bonds on these projects.

**Without additional information, a fiscal impact could not be determined.**

**SOURCES OF DATA:** University of North Carolina General Administration; Department of Administration, State Construction Office

**TECHNICAL CONSIDERATIONS:** None

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**DATE:** May 13, 2009



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