

SUBJECT: Trust account or bond for construction retainage on certain projects

COMMITTEE: Business and Industry — committee substitute recommended

VOTE: 4 ayes — Oliveira, E. Rodriguez, Walle, Workman
2 nays — Orr, Villalba
1 absent — Bohac

WITNESSES: For — Chris Elsberry; Andrew Harman; Dennis Lewis; Richard Skipper; Fred Wilshusen, Texas Construction Association; (*Registered but did not testify*: Brian E. Chester; Brent Connett, Texas Conservative Coalition; Jon Fisher, Associated Builders and Contractors of Texas; Todd Hewitt; John Hinson; Nancy Jones, Plumbing Heating Cooling Contractors; Michael White, Texas Construction Association)

Against — Brad Greenblum, International Council of Shopping Centers; Mark Witte, Houston Real Estate Council; (*Registered but did not testify*: Mary Calcote, Real Estate Council of San Antonio; Daniel Gonzalez, Texas Association of Realtors; David Mintz, Texas Apartment Association; Gardner Pate, Texas Building Owners and Managers Association; Jim Short, Houston Real Estate Council; Bob Stout, The Woodlands Development Company and Newland Communities Texas; Chelsey Thomas, Texas Association of Realtors)

On — Michael Chatron, AGC Texas Building Branch

BACKGROUND: Property Code, sec. 53.101(a) requires a property owner to retain 10 percent the contract price of the work to the owner or 10 percent of the value of the work under which a lien may be claimed by contractors, subcontractors, laborers, and materialmen.

Property Code, sec. 53.001(11) defines “retainage” as an amount representing part of a contract payment that is not required to be paid to the claimant within the month following the month in which labor is performed, material is furnished, or specially fabricated material is delivered.

DIGEST:

CSHB 3316 would require a property owner who took a construction loan or financing agreement secured by a lien to deposit retainage payments for a contractor in a construction trust fund account (construction trust) at the time of payment to the contractor.

The funds would be held in a construction trust fund account for the contractor and would be used first to meet the owner's obligations legally provided to the contractor. Any funds remaining after the obligation to the contractor was satisfied could be used for other construction payments or owner costs. Funds in the construction trust would not be subject to seizure or offset by the financial institution or other creditor to the owner.

A property owner would have to create a construction trust that would be identified as such, and the owner would have to keep the account records and deposit amounts by project and provide a copy of the statement from the financial institution if the beneficiary requested it.

The provisions in CSHB 3316 would not apply to a property owner that took out a construction loan or financing agreement to pay for the construction, remodeling, or repair of a single-family residential house or duplex or related land development. The bill would not apply to an owner improving property if the value of the improvement was \$500,000 or less.

The property owner could obtain a bond instead of establishing a construction trust that met the same financial obligations as the construction trust and was in a penal sum equal to at least 10 percent of the value of the total of the original contract amount and normal and usual extras up to 15 percent of the original contract.

The bond would be dependent on the prompt payment for retainage for all labor, subcontracts, and materials furnished to accomplish the work agreed upon in the contract and would be for the purpose of protection and use of each claimant due a payment. The bond could not be subject to any obligation other than payment to the contractor. If the property owner took out a bond in lieu of a construction trust, the owner would have to provide proof of the bond.

If the property owner did not provide proof of the trust or bond, the contractor could suspend contractually required performance.

The bill would take effect September 1, 2013.

**SUPPORTERS
SAY:**

CSHB 3316 would correct a deficiency in lien law relating to retainage on construction projects, ensure that developers followed current Texas law, and ensure that contractors were paid for work they completed.

Current law already requires a construction project owner to retain 10 percent from each monthly payment of the contract price to be paid to the general contractor after project completion, but if the owner has financial problems that cause the lender to foreclose on the property, often the retainage is not there and the general contractor and subcontractor are not paid. CSHB 3316 would prevent this problem by requiring the retainage to be deposited in a separate bank account or requiring the purchase of a bond to pay retainage. The bill would ensure that the owners simply obey the law by safeguarding the funds that they are legally required to set aside for payment to contractors.

Current law regarding retainage allows the developer to essentially finance 10 percent of a project with money owed to the contractors, which could lead the lender to underfund the project. Requiring retainage funds to be set aside would keep all interested parties honest, reflect the true cost of a construction project, and put the borrowing risk squarely where it belongs.

Fears that the bill would increase the cost of borrowing and construction are exaggerated. Stakeholders have suggested that the current equity requirements are in the 25 percent to 35 percent range, and the bill would pose a maximum potential increase of 10 percent. A bond in lieu of setting aside funds in a construction trust would probably be in the 1 percent to 1.5 percent range.

Critics should recognize that problems recovering retainage are well documented in testimony and can cost a contractor hundreds of thousands of dollars on a single large project. If it were not an issue, there would not be so many contractors asking for a statutory requirement to ensure they receive the payments rightfully owed to them.

The bill would not create burdensome regulation, only a mechanism to ensure developers complied with the law that many are currently violating. The administrative requirements are quite simple and only require the developer to prove the retainage is being set aside with a statement.

OPPONENTS

CSHB 3316 would increase the cost of development, create needless

SAY: regulation and administrative burden for a problem that is not widespread, and shift more risk to the developers.

Large commercial property development already requires a substantial equity investment on a project, and this bill would only increase that amount. Some estimates could push the equity investment to over 50 percent, not only making construction more expensive but making it harder to do at all. Lower investment in major construction would mean fewer construction jobs and less economic development in the state.

The bill would require developers to open separate trust accounts, creating new accounting and compliance policies for something that contractors cannot prove is a substantial problem. Foreclosures certainly have been higher during the economic decline over the past few years, but the state should not create burdensome administrative requirements for a temporary and rare problem. Moreover, there is nothing that currently prevents a subcontractor for asking that this provision be put in a contract. The problem should be addressed between the interested parties, not by creating new laws.

The bill simply would create a special benefit to contractors and remove any risk associated with doing business from the contractor and place it all on the lender and developer. Risk is inherent in construction projects and that extends to all actors in the marketplace.