



Board Report

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Agenda Number: 34.

CONSTRUCTION COMMITTEE NOVEMBER 16, 2017

**SUBJECT: SMALL BUSINESS BONDING ASSISTANCE
PILOT PROGRAM**

ACTION: APPROVE RECOMMENDATIONS

RECOMMENDATION

CONSIDER:

- A. AUTHORIZING the Chief Executive Officer to award a Contract to Merriwether & Williams Insurance Services (MWIS) for a not to exceed amount of \$1,315,417 for a one year Bonding Assistance Pilot Program, effective January 1, 2018 to February 28, 2019, which includes a 2-month ramp-up period;
- B. ADOPT a resolution, Attachment A, authorizing the Chief Executive Officer and other Authorized Officers to negotiate and execute a \$4,000,000 line of credit with Bank of America at a cost of \$18,000 and to execute as needed, individual standby letters of credit at a cost of \$2,000 each or 2% of the value of each letter of credit executed, whichever is greater, for the pilot year;

(REQUIRES SIMPLE, SEPARATE MAJORITY VOTE OF THE FULL BOARD)
- C. AUTHORIZING the Chief Executive Officer to approve a no cost Memorandum of Understanding (MOU) with the City of Los Angeles for participation in the City's Contractor Development and Bonding Assistance Program (CDBAP) for a one year Pilot Program; and
- D. AMENDING the FY18 budget for \$1,413,417 to include the contract with MWIS, and the associated line of credit and standby letter of credit fees.

ISSUE

The Small Business community has expressed concerns that obtaining the necessary bonding for small contractors has been a barrier to participating in Metro construction contracts. The City of Los Angeles has also identified bonding as a barrier for small contractors and implemented the Citywide Bonding Assistance Program in 2005.

The City's Administration Office issued a Request for Proposal (RFP) in October 2015 for continuation of their existing program and asked Metro to participate in the RFP process. Metro

participated in the RFP process after receiving approval from the Board on May 20, 2015. Metro was included in the City's RFP as an optional provision for Metro to contract for services included under the terms of the original RFP. The City's RFP Panel selected Merriwether & Williams Insurance Services (MWIS) as the broker. The program and contractor were approved in April 2016 by the City of Los Angeles. The approved program allows Metro the opportunity to piggyback off of the City's program by executing a no cost Memorandum of Understanding (MOU) with the City and entering into its own contract with the broker.

BACKGROUND

Government agencies are required to obtain, from their prime contractors, performance and payment bonds on public works contracts over \$25,000. Payment bonds are required by Public Contracts Code Section 7103 and shall be equal to 100% of the contract price. Public Contract Code Section 6825 requires a design-build entity to provide payment and performance bonds for the project and in no case shall the payment bond be less than the amount of the performance bond. FTA Circular 4220.1f states the Common Grant Rules require performance and payment bonds in the amount of 100% of the contract price for construction contracts. Therefore, Metro construction contracts require its prime contractors to provide Payment and Performance bonds in the amount of 100% of the contract price in the form and format provided by Metro.

Public Contract Code Section 4108 states it is the responsibility of each subcontractor submitting bids to a prime contractor to be prepared to submit a faithful performance and payment bond, if so requested by the prime contractor. It should be noted that this same Section requires the prime contractor to state in its written or published request for bids if the expense of the bond(s) is to be borne by the subcontractor.

MWIS

MWIS, a certified small business, administers the City's CDBAP. Metro will have its own contract with MWIS to administer Metro's one year pilot program by piggybacking off the City's CDBAP. As part of this Contract, MWIS will subcontract with a certified small business and DVBE firm. MWIS has committed to a 10% goal (7% SBE and 3% DVBE). Metro recommends the establishment of a \$4,000,000 program line of credit with a \$250,000 maximum or 40% (whichever is lower) per transaction cap dollar amount. The City's CDBAP has the same established limits. Metro assembled a Bonding Task Force, consisting of key departments such as the Diversity & Economic Opportunity Department, Risk Management, Treasury, Vendor/Contract Management, and Project Construction Management. For the one-year pilot program, the Task Force decided to utilize the same program parameters, such as the Line of Credit and the per transaction cap dollar amount, as those established in the City's CDBAP.

A one-year Pilot Program will afford Metro time to conduct its own assessment, evaluate the program as it relates to future Metro projects, modify the Program as necessary and determine if Metro should continue with the City or create its own stand-alone program. Further, the \$4 million program line of credit and the per transaction \$250,000 cap are justified given that this is a Pilot Program and that the Program can be changed to better fit Metro upon completion of the one-year pilot.

The City's CDBAP, along with other programs administered by MWIS, have included up to a 40% bond guarantee amount even though their average guarantee is 23%. Metro will therefore be seeking

a bond guarantee amount up to 40% to go with the per transaction cap of \$250,000. Metro feels that by starting small, Metro minimizes its risk by only taking on a piece of the risk in the event of a default. Metro would have zero discretion on regaining a loss from a bonding company in the event of a default.

In addition, Metro will be conducting a one-year assessment of what services need to be conducted on an on-going basis by a provider and what services can be brought in house and whether additional FTE(s) positions are necessary (as part of the evaluation of the Pilot).

Metro will require that MWIS maintain accurate records of all program transactions, monitor all issuances of collateral through contract completion, report monthly to Metro on all transactions including outstanding collaterals, and provide a 12-month report that provides Metro with program specific data that Metro can utilize in order to determine if the program will require any changes and or modifications.

DISCUSSION

The Program will assist in providing DBE, SBE and DVBE firms the maximum opportunity to expand their bonding capacity on Metro construction contracts as a prime contractor or subcontractor. There are firms that are willing and able to bid on, compete for, work, and complete public works construction contracts but are unable to do so due to the inability to secure the required bonding or because they cannot meet the strict financial requirements demanded by financial institutions. In offering bonding assistance to these firms, Metro will provide a bond guarantee to qualified contractors looking to increase their bonding capacity.

The Program will be available to all SBE/DBE/DVBE prime contractors and subcontractors and is applicable to all Metro construction contracts that require bonding.

The Program will require that participants be assessed and put through a strict evaluation process in order to determine the contractors' credit worthiness. The program will require MWIS to conduct contractor consultations and make an assessment of the contractor in order to determine if they are qualified for bonding/prequalification. MWIS will then assess the contractor's bonding capacity, discern any deficiency reduction and identify available collateral support to facilitate the needed bondability. MWIS will also facilitate training sessions for contractors on industry specific topics (in depth coverage of specific topics such as "Bidding and Estimating" and "Contract Award and Management"), conduct matchmaking opportunities with Metro prime contractors and provide contract completion monitoring and risk mitigation support on all projects with Metro backed by bond collateral.

The Program will not be restrictive nor will it be capped. One misconception is that the per transaction amount of \$250,000 is too low and it is restrictive to contractors that are looking to increase their bonding capacity in a larger amount. The \$250,000 per transaction amount is not restrictive and in no way is it representative of the actual bonding amount that the contractor will obtain. The \$250,000 amount provides a maximum bonding Guarantee amount (assumed risk) that the Agency is willing to take on in the event of a default. Sureties are more likely to award a higher bond guarantee to program participants as a result of Metro assuming some part of the risk.

Furthermore, the City's program has a low default rate with only one default in the last 12 years.

The Program will not alleviate the Contractor or the surety of the entire bonding obligation. Another misconception about the bonding assistance program is that it awards bond guarantees to new contractors who have no public work experience or high risk contractors that cannot secure commercial bonding on their own. Although the program is open to new and emerging contractors, there are strict checks and balances in place to evaluate these contractors and verify that they are solvent, established firms that can perform the contract. Further, the Program is designed to assist new and emerging as well as intermediate contractors that are looking to build upon their capacity. The majority of the participants in the City's Program fall into the latter. The Program is designed to assist contractors in building up their bonding capacity and not for Metro to take on their entire risk or alleviate the Surety and Contractor of all their responsibility. The Program is not intended to provide bonding assistance to small businesses that can secure a commercial bond on their own nor is it intended to grant credit to non-viable firms.

Miscellaneous Program expenses include, but are not limited to, the cost of the line of credit for one year (\$18,000) and \$2,000 or 2% for each letter of credit executed (whichever is greater).

After the expiration of the 12 months, MWIS will provide Metro with a Program Stewardship Report that will detail all program transactions, outstanding collateral and, in the event that the Pilot Program is not renewed, a closeout cost proposal for monitoring of outstanding collateral.

FINANCIAL IMPACT

The cost to execute a \$4,000,000 Line of Credit with Bank of America, Metro's contracted financial institution, is 0.45% of the total amount, or \$18,000 for one year. In addition, the fee to execute individual stand-by letters of credit is up to \$80,000 per year, depending on the number executed.

Metro is also requesting the approval of a contract with MWIS for a One-Year Pilot in the amount of \$1,315,417.

Impact to Budget

The MWIS contract and the Line of Credit fees will be added to Cost Center 2130. Funding will come from General Funds, which are eligible for Metro Bus and Rail operations and capital expenses. Costs for individual letters of credit will be paid by the projects for which the contractors are providing services.

ALTERNATIVES CONSIDERED

Staff conducted an extensive benchmarking of bonding assistance Programs that are currently being administered by various agencies around the country. DEOD reviewed a total of 19 Bonding Assistance Programs throughout the country. Of the 19 programs surveyed, ten operated under the Merriweather & Williams Insurance Services (MWIS) model, with MWIS as the Administrator; two other models were similar to the MWIS model, offering a Bond Guarantee; six offered Bonding Education courses with no Bond Guarantee amounts; one (Denver RTD's Subcontractor

Performance Self Insured Program) is a Self-Insured Program.

Staff recommends a one-year Pilot Program with the City. The RFP process is complete and requires the execution of a no cost MOU with the City. If Metro was to initiate a stand-alone program, Metro would need to initiate a new RFP. The City's program also allows Metro to negotiate its own contract with the selected broker and participate in a shared cost model with the City. Metro's benchmarking has already established that 12 of the 19 agencies that provide bonding assistance utilize programs that are similar to the City's program. Initiating a standalone program at this time is not recommended due to the lack of available data for development of a stand-alone program.

NEXT STEPS

- Upon Board approval, staff will executive a Contract with MWIS for a One-Year Pilot Program.
- Executive a No Cost Memorandum of Understanding with the City of Los Angeles for a One-Year Pilot Program.
- Execute line of credit with Bank of America and set-up the process to execute individual stand-by letters of credit as needed.
- Program Launch in March 2018.

ATTACHMENTS

Attachment A: Board Resolution to Authorize Line of Credit

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