Expanding Access:

Contracting Solutions Driving Economic Value

ori-gen

LEGACY | DIVERSITY | COMMUNITY

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This white paper was conceived and developed by Ori-Gen, through participation in the 2023 Ascend National Cohort Program. As a business services provider, Ori-Gen serves as a catalyst for community building by providing legacy enterprises with the tools to strengthen the diverse communities in which they operate.

Ori-gen was founded on the principles of legacy, diversity, and community. Our values are in alignment with those of the United States Constitution which promises citizens the equal rights of life, liberty, and the pursuit of happiness. Unfortunately, the economic data does not always support these fundamental principles. We have found that insurance, bonding, and access to capital are factors that play a critical role in inhibiting small and diverse businesses, reducing participation and competition. The results are excessive pricing, decreased innovation, and a higher tax burden on our citizens. Firms such as Merriwether & Williams Insurance Services, a HUB International Company, partner with public entities throughout the country to provide solutions to reduce the ongoing issue of economic inequality in our country. Utilizing these resources in insurance, bonding, capital access, and data reporting, can provide measurable and sustainable impacts for small businesses, communities of color, and local economies.

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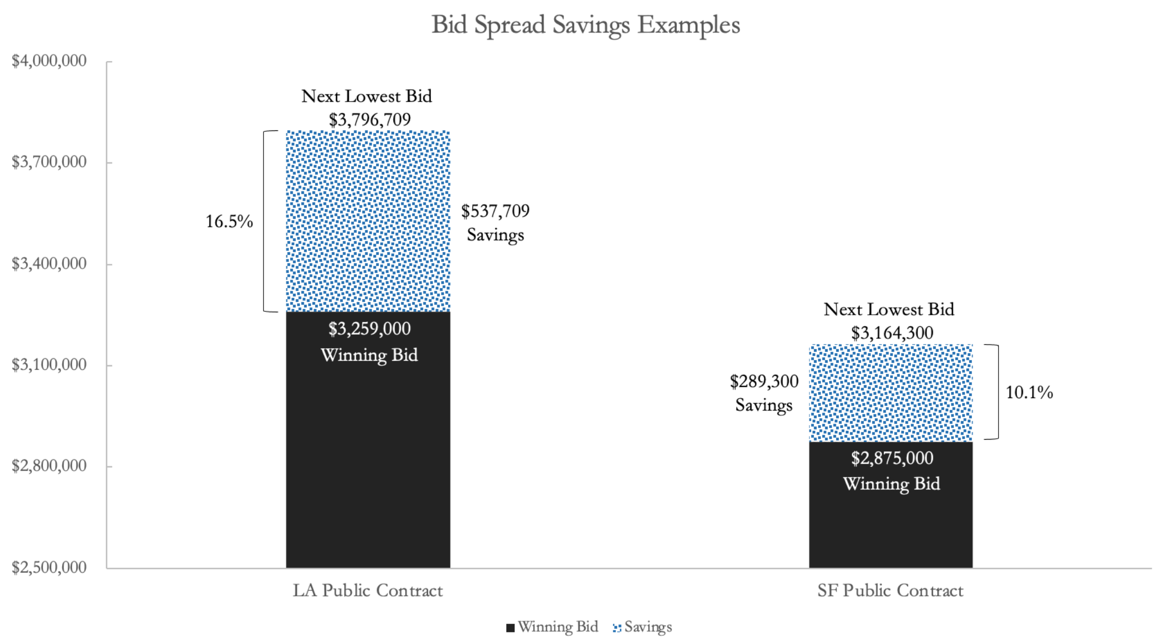
The contents of this document were prepared by University of Washington's Foster School of Business MBA students Ayush Garg and Michael Taylor.

For the purpose of this report, our team analyzed data publicly available on the government's USASpending.gov website.

Executive Summary:

Increased access for contractors bidding on publicly-funded construction projects undeniably drives cost-savings and economic value.

According to the cities' Contractor Development and Bonding Program reports, projects with multiple bids averaged savings of $245,000 per contract in Los Angeles and $130,000 per contract in San Francisco since 1995. These bid spreads represented 13.6 percent savings between the program supported low bidder and second low bidder, on average. Unfortunately, only 47 percent of projects reviewed during this period received more than one bid.



The California State Legislature's stated goal of constructing 2.5 million homes in the next 8 years could take $2 trillion in government spending. Given the immense scale of this figure, generating savings on this project is crucial. If the state expands procurement practices and meets the stated spending goals of 40 percent to local businesses, bid spread savings and recirculation benefits could generate net savings of 12.4 cents for every dollar spent, up to $248 billion. (See *Who Foots the Bill?*)

Barriers in the forms of burdensome certification and contracting procedures, lack of access to capital to amplify business growth, bonding requirements for oftentimes unattainable collateral, inconsistencies in insurance standards, and disproportionately high insurance premiums currently impede California's many small contractors from participating to the extent necessary to meet the state's goal.

Coordinated reforms of outdated procedures, expansions of business support services, and industry-wide standardization of OCIP policies provide promising avenues to increase competition in contract bidding. Additionally, supplemental workforce training programs can grow the supply of skilled labor and enable California to rise to the housing challenges that face the state over the next decade.

Background:

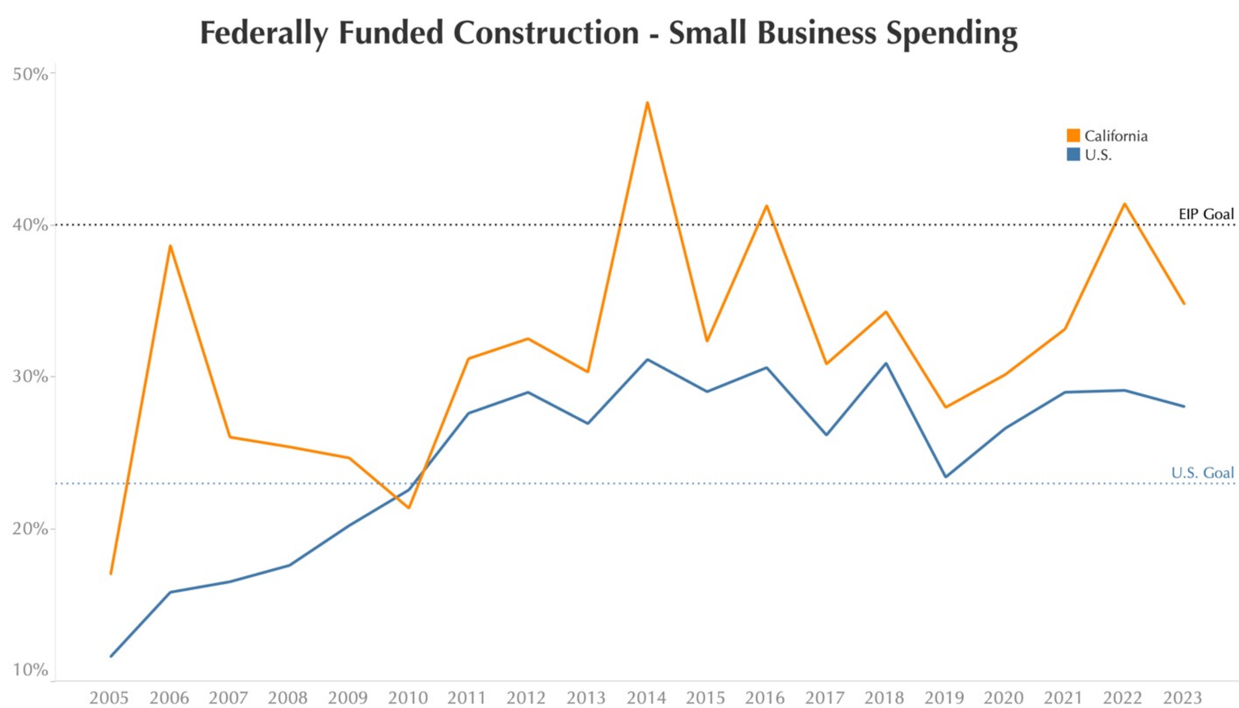
In 2022, the state of California generated greater than $3.6 trillion in GDP, representing 14 percent of the U.S. total and more than 24 other states and the District of Columbia combined.[1] Of this staggering figure, an estimated $120 billion was added through the construction industry.[2]

Federal Spending

For small businesses, the U.S. Code sets the government-wide goal for total value of all prime contract awards at 23 percent for each fiscal year. This guidance is further delineated into goals of 5 percent to small businesses owned and controlled by socially and economically disadvantaged individuals (disadvantaged business enterprises [DBEs]), 5 percent to small businesses owned and controlled by women, 3 percent to small businesses located in historically underutilized areas (Historically Under-utilized Business Zone [HUBZone] firms), and 3 percent to small businesses owned and controlled by veterans.[3]

Data shows that overall, the Federal Government is achieving its stated SBIR spending goal. In 2022, the Small Business Administration (SBA) reported $162.9 billion, or 26.5 percent awarded to small businesses. While falling just short of the set-aside goals for female owned and HUBZone businesses, the government met and exceeded its goals in all other areas.[4]

Federal dollars spent specifically on construction have also exceeded the 23 percent goal in recent years. When those dollars are spent in California, the percentage of spending on small businesses is even greater. Over the past 19 years, 24.8 percent of federal spending on construction has been distributed to small businesses. In California, the total over the same period is 30.4 percent.



Equity in Infrastructure

The Equity in Infrastructure Project (EIP) is a national coalition formed in late 2021that currently consists of 59 public agencies, including 13 operating in the state of California. Founded to deliver on the White House's Justice40 Initiative and Executive Order 13985, the organization works to increase the share of federal contracts that go to small and disadvantaged businesses.

The annual goal to which all pledge-signing members have committed is 40 percent participation by small and disadvantaged businesses in publicly funded infrastructure projects. This goal casts the data displayed in the graphic on the previous page in a new light. Despite drawing nearly two thirds of its population from diverse communities, California has achieved 40 percent participation only 3 times in the past 19 years. When including the entirety of the U.S., EIP's goal has never been met. Clearly, federal dollars for construction are flowing into the economy, but are there existing mechanisms, infrastructure, and skilled workers in place to ensure that the spending can be activated and optimized for its full local economic multiplicative?

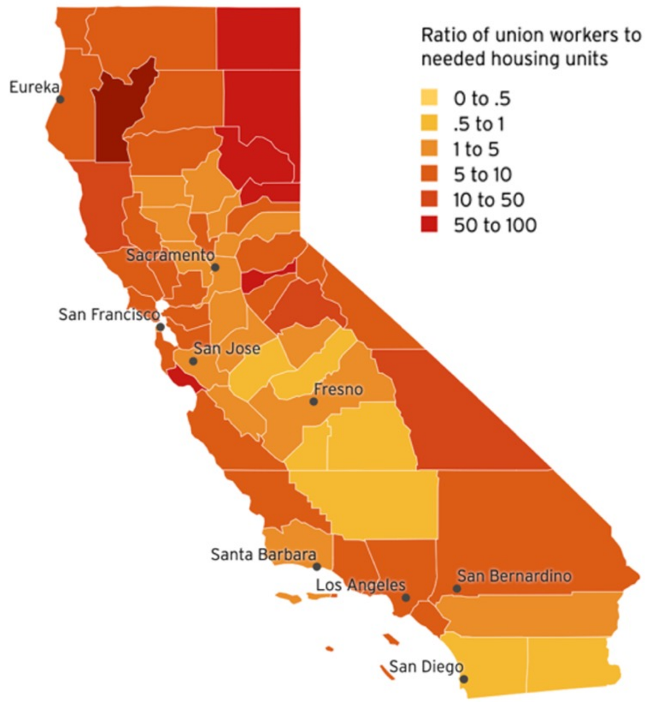
Contracting & Labor in California

The State Building & Construction Trades Council of California is an EIP pledge signee and represents 160 local unions with more than 450,000 construction workers. They estimate that at least another 2 million non-unionized workers exist across the state. Even with this total, the Trades Council believes the construction workforce needs to grow dramatically to meet California's goal of 2.5 million new housing units.[5] State bills paving the way for these swaths of residential construction add complexity to the matter by requiring every contractor and sub-contractor (sub) to employ a "skilled and trained workforce": 30 to 60 percent of employees must graduate from a state-approved apprenticeship program.[6]

The majority of apprenticeship programs in California are run by unions, although there are groups working to promote and expand their prevalence. Achieve Partners is a private equity firm focused on driving returns through social impact, primarily through workforce development. Ryan Craig, their managing director, writes that "a qualified workforce must be viewed as a public good. We desperately need more and much smarter public investment in workforce development." He points out that combined government spending on apprenticeship programs is miniscule when compared to that on college education by an astounding ratio of 1 to 1,000.[7]

This is further supported by California's Department of Industrial Relations data showing that 90 percent of all apprentice graduates come through union-directed programs. Dues and other assured sources of funding provide unions with the resources and capacity to meet the qualifications for state approval. Unfortunately, these programs are not robust enough to train the vast amount of new construction workers California desperately requires to meet its housing goal. Just 67,000 people have graduated from construction apprenticeships in the state since 2010.[8] Thoughtful and intentional public investment is needed to help the industry bridge its labor gap by developing a capable workforce.

The graphic below is sourced from the Trades Council, California's Department of Housing and Community Development, and Calmatters.org, and shows the areas where the shortage between qualified labor and desired housing is particularly magnified: San Diego County, Imperial County, and most of the Central Valley have less than 1 unionized worker for every 2 housing units needed. Much of the state falls below the similarly problematic ratio of 1:1.

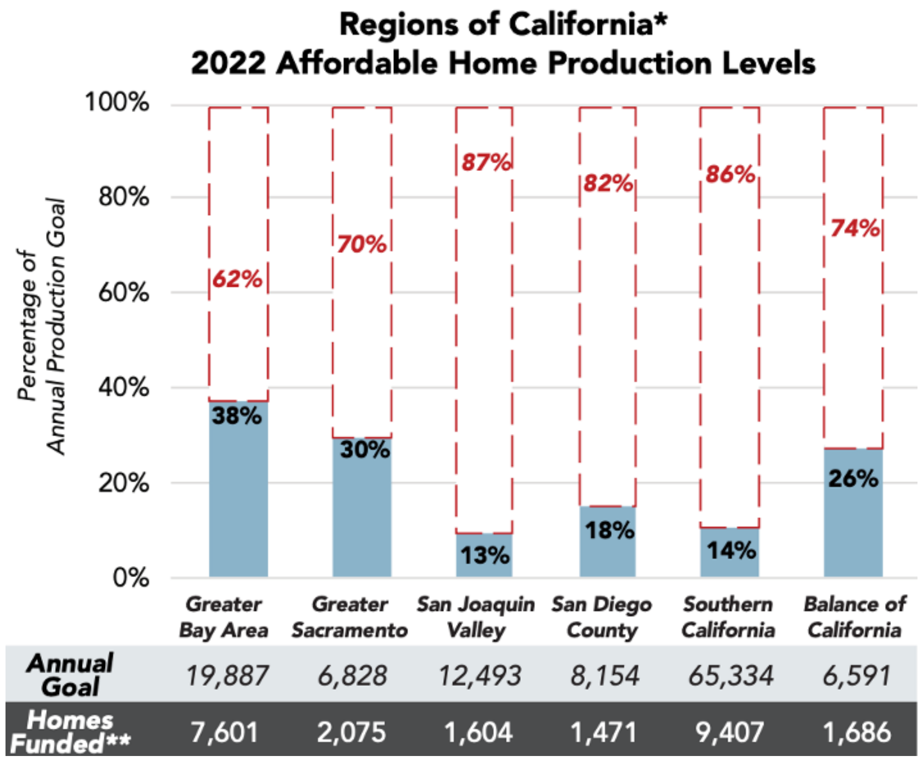


While it is clear that additional government initiatives are necessary to address the discrepancy between the demand for residential construction and the labor required, the state's legislators have already been prolific in the past several years. How has their action set the table for California to achieve its housing goal?

Recent Legislation

The 2023 legislative session yielded a housing package consisting of 56 bills designed to simplify and expedite new housing construction. According to the governor's press release: *"This legislation streamlines housing developments, allows institutions like colleges and religious organizations to use portions of their property to build housing, and continues a state statute used to hold local communities accountable for their fair share of housing."* Many of the bills focus on accelerating the approval for affordable housing by simplifying the associated processes, particularly in cities that have failed to meet their housing goals. Others allow for taller residential structures, sanction pre-approved accessory dwelling unit plans, and expand requirements for replacement housing after demolitions.[9]

[The California Housing Partnership](#) is a private non-profit organization formed by the State Legislature, and a national leader in affordable housing finance and preservation policy. The graphic below is sourced from their [2023 Report](#) and draws on data from their Preservation Database. Significant ground remains between the annual goals stipulated by the Legislature and the construction that is presently occurring, particularly in Southern California and the San Joaquin Valley.



The legislation targeting procedural improvements will do its part to contribute to more effective siting and permitting for residential construction, much needed as California attributes 14 percent of all affordable housing costs to consulting and administrative fees, the highest figure in the country.[10] But clearly, much work still must be accomplished to mobilize and scale the action needed to close the evident gaps. Meanwhile, we must additionally consider the status of the many Californians who hope to live in this new housing.

The People

California is one of six states in the US where no race or ethnic group constitutes a majority of the population. Additionally, 27 percent of Californians (over 10 million) are immigrants, more than twice the share of the nation as a whole.[11] Foreign immigration, however, has slowed in recent years, and the state's total population recently peaked and declined in 2021 for the first time since 1900. This impact has been driven by a doubling of domestic migration over the past two years. More than one third of residents are considering leaving the state due to housing costs.[12] Improved housing affordability will be crucial to checking future out-of-state migration.

Data from the Public Policy Institute of California shows increasing concern over residential prices, particularly in minority communities. In a survey conducted in January of 2023, 70 percent of all responders said that housing affordability is a big problem in their area, while African Americans are 6 times as likely as whites to consider housing costs as the most concerning issue in the state.[13] These fears can be explained by the state's exorbitant median home sale price of $785,600, trailing only that of Hawaii.[14] Difficulties with housing are also reflected in recent data gathered by UC Berkeley that shows in 2022 an average of 171,000 people lived outside of a house on a given night, the highest rate of nightly homelessness in the nation.[15]

California has a long history of vibrant ethnic communities, but these groups face the growing threat of gentrification, particularly in the state's most populous cities. Los Angeles County exhibits the highest rates, with 10 percent of all housing tracts falling between the classifications of Advanced Gentrification and At Risk of Gentrification. An additional 5 percent experience Ongoing Displacement of Low-Income Households according to data from UCLA's Urban Displacement Project. Gentrification frequently increases housing prices, driving original residents to relocate. This effect can create a chain of negative consequences as displaced households may be forced to settle in areas with fewer community connections, migrate out of state, or struggle to regain housing entirely. Although these deteriorating conditions predominantly impact minorities, the secondary effects damage California's larger economy. Ethnic communities have historically proved fertile grounds for small business development and, ironically, impacted residents may be more likely to work in construction.[16]

In Summary

California's housing crisis has developed both acute and chronic characteristics. Gentrification, unaffordability, and lack of housing are all severely impacting citizens in the present, acutely. The sheer magnitude of the undertaking that must be accomplished to alleviate these conditions threatens to extend the challenges chronically into the foreseeable future. Federal spending assistance exists but must be activated and applied efficiently to be truly beneficial. While coded mandates for small business participation are being met for the funding distributions, the more ambitious goals that offer opportunities for cost-savings and economic relief will require more work to reach. Significant expansion of the state's construction workforce is needed, but crucial programs to nurture skilled labor are currently lacking. Recent legislation aims to streamline housing development, but a significant disparity remains between legislative goals and actual construction, while housing affordability concerns persist, especially among minority communities. Population dynamics, including a diverse demographic landscape and immigration trends, further accentuate the urgency for comprehensive solutions to address California's entangled housing problem.

Analysis:

California's Housing Crisis – Who Foots the Bill?

The price for constructing affordable dwelling in California has recently reached the astronomical figure of $1 million per unit.[10] This analysis will estimate an average cost of $800,000 per dwelling. To build the 2.5 million homes legislators have indicated will be necessary in the next 8 years to alleviate the state's housing crisis, it could take an estimated $2 trillion in spending. Using a conservative baseline of 10% from the average of 13.6% in savings generated on public construction projects with multiple bidders in California since 1995, expanded procurement practices could represent up to $200 billion in savings on affordable housing construction alone.

Although there is limited data estimating the difference in dollar recirculation between spending through local and national firms in construction, there have been a variety of studies exploring the phenomenon in other industries. San Francisco, Salt Lake City, and British Columbia have all conducted analyses detailing between 15-50% increases in the proportion of revenues recirculated in their economies in the retail and restaurant industries when dollars are spent at local businesses instead of national chains. The restaurant industry provides a particularly apt comparison for construction given the similarity of labor and materials sourcing. Civic Economics found that in 2012, 64.9% of spending in local-owned restaurants in British Columbia was recirculated again locally, compared to just 30.4% at chains.

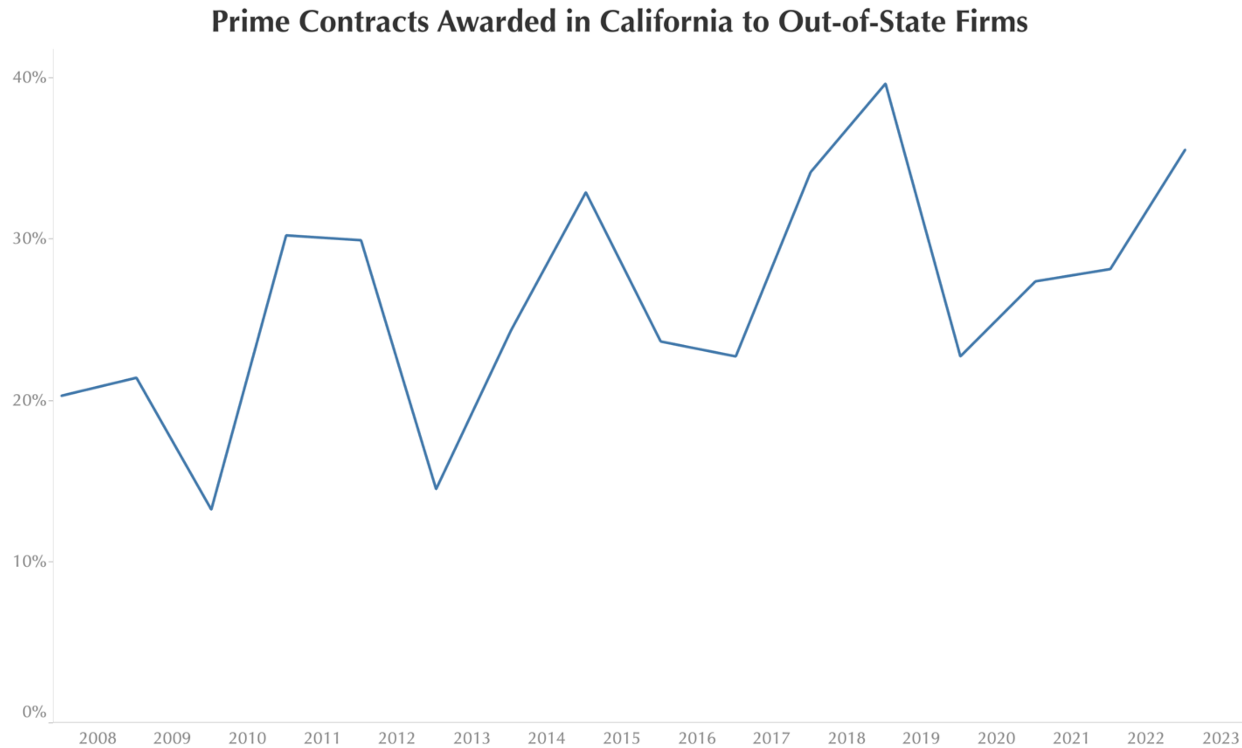
Assuming California can close the 9.6% gap in its goal to achieve 40% of infrastructure and construction spending going to small, local businesses, a conservative 25% small business contracting spending boost still translates to an additional $48 billion recirculated in local economies. This money ultimately goes back to pay the income and sales taxes which are used to fund more projects, continuing the cycle. All told, by expanding bidding access and living up to its inclusion goals, California can conserve 12.4 cents for every dollar spent on public projects. The resulting savings generated from both endeavors amounts to $248 billion dollars, a figure surprisingly close to the state's entire budget for the 2023-2024 fiscal year.

"Our coalition exists to create generational wealth in the infrastructure space for historically underutilized businesses. As this paper demonstrates, the savings achieved by expanding access for competitive bidding and recirculating incomes locally serves to grow the potential for that wealth immensely. More prime contracting opportunities means greater benefits for all Californians and all Americans."

- Equity in Infrastructure Project Leadership

Lost Recirculation Potential

Our analysis of the recipients of public funds spent on construction in California displays an unmistakable trend. Over the past 16 years, the percentage of lucrative prime contracts going to firms domiciled out of the state has been steadily increasing, reaching 35.6 percent in 2023.



The national real estate magazine, *The Real Deal*, recently conducted an analysis of building permits issued by the City of Los Angeles from a 3-year period between 2020 and 2023. Their rankings of the top 20 general contractors by total project cost reveal further confirmation that out-of-state firms are playing a considerable role in California's construction industry. The permits include private developments in addition to publicly funded projects, but the data tells a similar story. Out of the 20 highest earning firms over this period, 9 are headquartered outside of California and accordingly represent 57.3 percent of the earnings in their cohort.

Given the demonstrated benefits of recirculating capital in local economies, it is telling that California's economic issues are growing at the same time that national firms are cornering their construction industry. While national firms operate with economies of scale advantages, more than half of infrastructure projects still close after receiving only a single bid. A concerted effort to increase competition in the space by reducing barriers to the bidding process could serve to level the playing field.

The Barriers & Potential Solutions:

With the support of The James Irvine Foundation and the Social Impact Fund, Drexel University's Nowak Metro Finance Lab published an excellent report detailing their evaluation of the 5 barriers confronting small business participation in contracting opportunities. Our analysis has independently aligned with the majority of their work, so instead of reframing similar arguments, we will condense and briefly summarize their findings, seeking to augment them with additional material.

Barrier 1: Certification, Procurement Processes, & Lack of Coordinated Support

Small businesses must become and remain certified to qualify for participatory sub-contracting procurement goals. Outside of the standard documents asserting proof of identity, tax returns, and business licenses, applicants must also provide bank account information, financial statements, and a 5-year business plan.[17] The National Minority Supplier Diversity Council can take steps to streamline this process for the business owners it is tasked with supporting. Moreover, requirements often conflict between the many agencies handling these certifications in various jurisdictions. Conciseness, standardization and reciprocity between agencies are necessary to alleviate this pain point for small business owners.

Once firms have been certified, the current system restricts their growth by incentivizing small businesses to stay small so they can continue to qualify for participatory sub-contracting procurement goals. Caps on net worth and gross revenues limit firms' agility to both bid on larger projects and appeal to the developers seeking to hit participation goals. Smaller firms are essentially locked into sub-contractor roles with little opportunity to win bids as primes, sustaining a large gap between the very large primes and small sub-contractors. This gap is partly to blame for decreased competition.

Solution: Contractor Development Programs (CDPs)

A partial solution to this barrier already exists, but it requires expansion and unification. The cities of San Francisco and Los Angeles both offer free CDPs designed specifically to assist smaller contractors in navigating the complex web of public contracts. Enterprise certification, recordkeeping requirements, cash flow projections, project bid calculations, and regulations' nuances can severely complicate life for small contractors, holding them back from the work their business is built to perform. The CDP programs offer training workshops, technical assistance, and academies all led by industry experts to educate and simplify the many processes inherent to construction.

Additionally, certification requirements must be aligned and revenue caps re-evaluated to ensure that successful businesses can gain the ability to compete for bids and subsequently bring down overall project costs for developers and municipalities. This work must be accomplished at state and regional levels, thereby requiring engagement from legislators and industry leaders to bridge existing practices.

Barrier 2: Access to Capital

As they build their profiles, many small contractors naturally bid on contracts of increasing size in order to grow their businesses. Once they can demonstrate capability for accomplishing the work and succeed in winning potentially transformative bids, the real challenges begin. With limited financial reserves, quickly mobilizing labor, securing required bonds, insurance, and navigating working capital expansions for sourcing equipment and materials becomes problematic.

Solution: Financial Assistance & Bonding Programs

Bonding is frequently an obstacle preventing smaller firms from participating in public construction projects. The Los Angeles Regional Contractor Development and Bonding Program (CDABP) established by Merriwether & Williams Insurance Services, works with individual business owners by providing financial support for securing bonds, reviewing bidding application documents, and increasing bonding capacity, all at no cost to the business.

This is another example of an existing program that must be amplified and expanded. Bonding is a critical barrier (See Local Case Study), but it is far from the only impediment that stretches liquidity capacity for small business owners. The structure for unified guidance programs and policies for sourcing materials and contracting labor can be defined on city, regional, or even state levels.

Local Case Study:

Karl Percell II, President of KPA Constructors, stands as a rare example of an ambitious business owner who has been able to successfully overcome many of the barriers that prevent entry and hinder growth for small contractors. A professional engineer licensed in California, his journey into construction was influenced by his lack of access to the greater Los Angeles area due to the city's limited public transportation during his studies at the University of Southern California. This experience fueled his passion for reshaping urban connectivity by developing transformative infrastructure initiatives such as the LA Metro expansion.

Despite facing initial hurdles as a small business owner, Percell's perseverance led him to establish KPA Constructors, specializing in low-voltage electrical systems. Their earlier projects consisted of hourly work or segments of larger contracts that had been divided to allow small contractors to participate without bonds.

As his company built its reputation, it gained access to larger, more lucrative projects. Bonding issues loomed large, however, hindering the company's ability to participate in these critical opportunities to expand the business. A pivotal moment came in 2020 when his company won a bid for a $3.7 million LA Metro project, shedding light on the crucial role bonding plays in accessing larger contracts.

KPA was told they needed to secure 10 percent of the entire contract's value in cash before their broker could post the bond that would allow them to begin work. After working tirelessly to raise the capital through their network of family and friends, they found that the total had increased to 20 percent. The Contractor Development and Bonding Program (CDABP), spearheaded by Merriwether & Williams Insurance Services, proved instrumental in overcoming this obstacle. Through collateral support, KPA Constructors was able to finally secure the crucial bond, enabling them to embark on future multimillion-dollar projects that would otherwise have been out of reach.

"Because we were able to complete our (LA Metro) project, there is now a train that operates. If I were to return to USC now, my lived experience would be so much richer because of that access. Infrastructure projects are opening the world up to people from these communities."

- Karl Percell II

Percell's vision extends beyond business success; for him, it is about creating opportunities for future generations. He sees infrastructure projects not only as means of transportation but as catalysts for social change and economic empowerment. Mindful of the broader socio-political landscape, he advocates for expanded inclusion in public works contracting, thereby building stronger, more connected communities. At their operating peak, KPA employs 24 workers on union wages. The families depending on that income pay the taxes that fund these projects and shop locally, redistributing the dollars further throughout the community. The projects enabling this economic growth facilitate opportunities that can affect generations of local citizens.

Looking forward, KPA Constructors is poised to continue its trajectory of success, armed with an expanding résumé and a strong commitment to community advancement. Percell's story not only underscores the journey of a determined business owner but also highlights the systemic challenges faced by small contractors in the construction industry as well as proven solutions to lower these barriers.

Barrier 3: Insurance Inconsistencies

California's insurance market has grown increasingly segmented as coverages are less attainable and more costly. Market conditions have led to fewer regulator-approved options while rising settlement costs for claims have resulted in an additional social cost of insurance by inflating premiums. Smaller contractors and sub-contractors frequently have difficulties securing insurance coverage for more lucrative jobs due to the restrictive requirements for coverage and incur disproportionately high insurance rates, making it difficult for them to remain competitive.

The ExMod Rating is a workers compensation metric required to attain contracting insurance coverage on most public projects in California. One of many factors insurers use to determine client risk when calculating premiums, this condition is detailed in California's Worker Compensation Experience Rating Plan and necessitates a minimum of 4 years and 9 months of payroll data to generate a rating. Importantly, employees are a requirement for a verified state rating, so sole proprietors are essentially eliminated from consideration.

Finally, lazy contract language, frequently employed by developers and general contractors, can result in mismatched insurance requirements and job risks. Sub-contractor pre-qualification is regularly outsourced to third-party verifiers. A recently published sub-contractor outreach informs applicants that they must submit 3 years of CPA-prepared financial statements, a 5-Year ExMod rating, and 5 years of Occupational Safety and Health Administration (OSHA) forms. Not only must potential sub-contractors have been in business for the past 5 years, but they must also have paid for professional accountants during that time. The entire prequalification process reduces consideration of small and diverse sub-contractors.

In comparison, the City of Long Beach provides an excellent example of creating a simple process for inclusive insurance requirements that benefits all applicable parties. Their recent ordinance for the Harbor Department separates work activities into low-risk and high-risk buckets, describing acceptable insurance coverages for each.

Solution: Implementing an Owner Controlled Insurance Program (OCIP)

An OCIP allows multiple parties to secure coverage under the same unified plan. The single policy names the developer, general contractor, and sub-contractors as insured parties for the entire construction project. This wrap program offers all the typical liability, workers' compensation, and builders' risk insurance coverages that are necessary to attain building permits.

While wrap policies require advanced planning to establish, they offer significant benefits for both developers and contractors. The primary advantage gained is efficiency. Bulk insurance can significantly lower the overall insurance cost for projects and allow for rapid contractor enrollment, cutting lead times. In the event of a claim, OCIPs offer a streamlined procedure for settlements and payouts, and they have standardized mechanisms for separating the contractors from OCIP-covered claims when they are not at fault.

Sub-contractors, particularly small businesses or sole proprietorships, stand to benefit meaningfully from an increased prevalence of wrap insurance. By directly removing the barrier requiring contractors to obtain their own insurance coverage, subs can bid for projects based solely on their capacity to perform the work instead of their ability to pay expensive premiums upfront. They may also qualify for previously unobtainable projects by accessing coverages they could not receive on their own. These aspects can further lower overall development costs by increasing competition for sub-contracting work with a larger pool of available talent.

"It is unfair to expect small and disadvantaged businesses to compete on an equal footing in the public contracting sector when both the prime contractor and sub-contractor are required to have the same insurance coverage. For most small businesses, capital is scarce, and procuring the same coverage can be a significant financial burden. I have seen the cost of premiums increase by up to ten times due to changes in the insurance requirements of contracts, endorsements that only major contractors have access to, and coverages that are mandated but do not apply to the services that the sub-contractor provides. As a result, small businesses are unable to compete and maintain the contract, which perpetuates the inequity in the public contracting sector. It is no surprise that the set-aside goals are not being met."

- Karla Daniels
Policy Star Founder & CEO

Conclusion:

Increased competition in government funded public works projects has been proven to generate cost savings while providing local employment opportunities. Moreover, California's housing crisis demands urgent attention. Actions to support infrastructure bidding competition, expand the construction workforce, and consequently address affordability concerns necessitate coordinated efforts from the state's leaders.

To increase competition, project owners can create guidelines and requirements for adding smaller contractors to their supply chains. Large public projects offer the opportunity to carve out separate projects for bidding, creating greater accessibility for a variety of firms. These smaller projects can allow developers to include diverse candidates and make progress towards inclusion goals. The fastest way to move the needle on participation, however, is for project owners to implement policies that help move small businesses from sub-contracting roles to prime. This allows the total dollar value of the contract to count towards the goal and gives disadvantaged contractors the opportunity to even the playing field when bidding on future projects.

The state has programs in place to collect information on contractor demographics, incentives for inclusive procurement practices, and funding for contractor support services. Municipalities that benefit from public funds must capitalize on these data by standardizing set-aside goals across all local projects. Many participation goals are currently set somewhat arbitrarily. On a municipal or even state level, a unified standard that aligns with local contract licenses or the ethnic demographics of local communities would be a powerful step towards driving inclusion across publicly funded construction.

The deteriorating conditions for minority communities and California's need to activate its construction workforce to reach affordable housing development goals combine to create a strategic opportunity to empower the state's citizens. Dedicated sources of capital to fund supplemental workforce training programs for apprenticeship certification, expanded requirements for contracting among small businesses and disadvantaged business owners, improved and simplified processes for the state's contracting procedures, and supportive services such as procurement readiness programs can provide California with the means to meet the rising challenge presented by its housing crisis.

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