

# Drinking Water Revolving Fund Construction Phase Guidance

## Michigan Department of Environmental Quality

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## **I. Order of Approval Issuance**

Following the issuance of your Order of Approval you will receive a Construction Phase Information letter from your Michigan Department of Environmental Quality (DEQ) project manager that includes:

- A. Blank "Request for Disbursement of Funds" forms. Your first disbursement to cover incurred expenses may be requested immediately upon loan closing.
- B. A list of the required contents of the signed contract document(s).
- C. A request that DEQ be notified of the preconstruction meeting.

## **II. Submittal of Executed Contract Documents**

Following the loan closing and signing of the construction contract(s), one complete, signed copy of each contract document is required to be submitted to your DEQ project manager. Each signed contract document must include the following items:

- A. Agreement
- B. Addenda
- C. Payment Bond
- D. Performance Bond
- E. Notice of Award
- F. Notice to Proceed

## **III. Loan Disbursement Procedures/Information**

- A. No loan disbursements that include construction costs will be processed until signed contract document(s) are submitted to the Revolving Loan and Operator Certification Section (RLOCS) of the DEQ.
- B. Only one loan disbursement request may be submitted in a single calendar month (submittal date may be different within the month).
- C. The first and last disbursement requests must be mailed so that RLOCS receives the authorized representative's original signature. All other disbursement requests may be faxed.
- D. All DWRF loans include a six percent contingency that is based upon the total loan amount after the construction bids have been received. The six percent contingency may be used for eligible overruns on any loan line items.
- E. Underruns on one line item may be used for overruns on another line item, provided the overrun is an eligible expense.
- F. The loan recipient should contact the DEQ project manager if the cumulative costs incurred during project construction exceed the DWRF loan amount.

- G. If the DWRF loan amount is exceeded, the loan recipient is responsible for any additional costs incurred in completion of the project for which the loan was approved. There are no loan increases.
- H. The contingency may be available to cover the cost of items not initially included in the loan. Approval from the DEQ project manager must be requested and received before including the item on a Request for Disbursement of Funds form.
- I. All project costs must be documented, regardless of whether or not they are eligible for DWRF assistance, with copies of the supporting documentation submitted to the DEQ project manager.

It is suggested that cost documentation be submitted with each disbursement request. Disbursement request processing will not be delayed until the documentation is reviewed; however, such timely submittal will allow the DEQ project manager to review documentation as the project progresses. This, in turn, will likely result in a more expeditious administrative closeout of the loan when the project is completed. However, the loan recipient may elect to submit the cost documentation at the time of project completion. While this requires submittal and review of invoices that are often several years old, this method may be preferred by some DWRF loan recipients.

#### **IV. Preconstruction Meeting**

- A. The following parties should be invited by the loan recipient or its consultant:
  - 1. Water supplier representatives and operating personnel;
  - 2. Project engineer/manager (consultant);
  - 3. Project inspector(s) and/or resident engineer(s) (consultant);
  - 4. Contractor(s) and subcontractor(s);
  - 5. DEQ project manager;
  - 6. DEQ Water Bureau staff;
  - 7. Utility service representatives (gas, electrical, telephone, cable, etc.);
  - 8. Michigan Department of Consumer and Industry Services, Bureau of Safety and Regulation, Construction Safety Division; and
  - 9. Other interested and/or affected parties.
- B. The following items are generally covered at the preconstruction meeting.
  - 1. Introduction of all parties, contact persons and telephone numbers.
  - 2. Preconstruction coordination: This includes discussion with affected utilities and services and each party's role in the construction project; interaction with other governmental agencies, including compliance with state and local ordinances and

permit requirements; and procedures for making payments to the contractor and retainage that will be withheld. (Attachment A is a guidance on the payment of retainage and the applicability of PA 524 to the loan programs.)

3. Construction related activities: This includes discussion of construction progress schedules; time and location of monthly progress meetings; construction testing requirements/procedures as outlined in the contract specifications; change orders and time extensions; shop drawing review, manufacturers' information, warranties and bonds, construction photos, inspector's logs and as-built drawings.
4. DEQ/DWRF involvement: Many of the DWRF issues and program requirements do not concern the majority of parties present at the preconstruction meeting. It may be more appropriate for the loan recipient, engineering consultant and DEQ project manager to discuss specific DWRF items immediately following the preconstruction meeting or schedule a separate meeting.

## **V. Project Inspection/Site Visits**

- A. The DEQ project manager and/or Water Bureau district staff will make site visits during the construction project as needed or upon request. Site visits should be held at the beginning and end of construction as a minimum. A copy of each construction contract progress schedule should be submitted to your DEQ project manager.
- B. Please notify your DEQ project manager of monthly progress meetings so s/he may attend as schedules permit. In addition, copies of the monthly progress meeting minutes should be submitted to your DEQ project manager and Water Bureau district staff.
- C. A final site inspection should be performed when the water supplier initiates operation of the project.

## **VI. Change Orders**

- A. Two copies of each change order must be submitted to the DEQ project manager as soon as they have been signed by all parties. If the loan recipient wishes to have an approved copy of the change order returned, then three copies should be submitted.
- B. Each change order should include the following information:
  1. Project name, project number, contract name or number, change order number, net cost of change order and revised contract amount, any additional days added to the contract and the revised contract completion date, and the signatures of the authorized representative, contractor and engineer with dates signed.
  2. A description of the change(s) and an explanation or reason for the change(s).
  3. Documentation to support the change and costs should be available.
  4. All applicable drawings and technical information
- C. All change orders must be submitted to your DEQ project manager for review. The loan includes a six percent contingency to cover allowable change order costs. There are no

loan increases so if the contingency amount is exceeded; the loan recipient will be responsible for the additional costs. Change orders must be submitted even if the loan is exceeded.

- D. The DEQ project manager will review change orders. To be allowable, a change order item must be within the scope of the loan project and conform with DWRF eligibility guidelines. The project manager will also provide a copy of submitted change orders to Water Bureau staff, who will review change orders for compliance with the construction permit requirements and technical acceptability.
- E. When change order reviews have been completed, the DEQ project manager will send a change order approval/denial letter to the water supplier. Change order costs should not be included in a loan disbursement request until the change order(s) has been approved by the DEQ.
- F. A loan recipient may appeal a change order determination. The authorized representative must notify the DEQ project manager in writing that they disagree with the determination and provide documentation to support their position.
  - 1. The DEQ project manager will review the supporting documentation and will notify the authorized representative whether the determination is changed or remains the same.
  - 2. If there is still a disagreement with the determination, the loan recipient may appeal further in accordance with Section 5418 of Part 54, Safe Drinking Water Assistance, of the Natural Resources and Environmental Protection Act, Act 451 of 1994.

## **VII. Operation and Maintenance (O&M) Manuals**

- A. Operation and Maintenance Manuals are not required by the DWRF program. However, if an O&M Manual is prepared, it is an eligible cost under the DWRF program.
- B. The loan recipient may provide O&M Manuals to the Water Bureau district staff for review. Please copy the DEQ project manager on the transmittal letter.

## **VIII. Initiation of Operation (I/O)**

- A. The water supplier is required to notify the DEQ project manager in writing when the project initiates operation. Initiation of operation is defined as the date when the project becomes capable of operation for the purposes for which it was planned, designed and built.
- B. It should also be understood that the target I/O date indicated in the loan application dictates the loan repayment schedule. The "actual" I/O of the construction project may differ from the target date specified, however, the repayment date of the loan will not change.

## **IX. Administrative Completion**

- A. MDEQ anticipates that a loan can be administratively completed within six months to one year after the project initiates operation. Administrative completion occurs after a

verification of final allowable project costs and confirmation that the scope of the loan has been completed.

- B. At or near substantial completion, which generally corresponds with initiation of operation, the consulting engineer develops a punchlist of deficiencies to be corrected. Once the punchlist items are corrected and other construction activities are completed, the consulting engineer and owner make a final inspection. If the work is satisfactory, the engineer prepares final acceptance documents and recommends the release of final payment and retainage to the prime contractor(s) or construction manager.
- C. In conjunction with the submittal of the contractor's final pay estimate, the authorized representative must certify that all work has been completed and accepted by the owner, all punchlist items have been addressed, and all retainage can be released to the prime contractor(s) or construction manager.
- D. Invoices and other supporting documentation must be submitted to MDEQ with each disbursement request. MDEQ cannot administratively complete a project until all costs are verified.
- E. The final disbursement request should tabulate eligible project costs, including those costs exceeding the loan amount. A disbursement request should not be marked "final" until approved final project costs have been established by the project manager. Your project manager will work with you to facilitate the preparation of a final disbursement request that reflects the appropriate, MDEQ-approved final cost figures.
- F. In most cases, your loan project will be ready for administrative completion as soon as the project manager has verified the final project costs and a final disbursement request that accurately reflects the approved final costs has been processed. If an overpayment has occurred due to ineligible costs being reimbursed, administrative completion must wait until the Michigan Municipal Bond Authority (MMBA) has received the proper repayment of the amount owed. If the verification of final project costs results in an amount equal to or less than the loan award, an administrative completion letter will be issued. When the final cost is less than the loan commitment, MMBA will recalculate the loan repayment schedule to reflect the lesser amount.
- G. Once the administrative completion notification has been sent, the MMBA will make any necessary adjustments to the loan, recalculate the loan repayment schedule if the final cost is less than the loan commitment, or use the existing repayment schedule. MMBA will notify the authorized representative in writing of the adjustments.

## **X. Record Keeping**

- A. Along with any records that loan recipients are required to keep by the Michigan Municipal Bond Authority, and as the result of other applicable statutes, it is suggested that the following construction related project records be kept:
  - 1. Bid advertisement information
  - 2. Bid opening information
  - 3. Contract award and contract document information
  - 4. Plans and specifications
  - 5. All addenda

6. All change orders
  7. All cost information including administrative, legal, and fiscal expenses, etc.
  8. All engineering agreements and invoices
  9. All invoices for pay certificates from the contractor(s)
  10. All loan reimbursement requests and records of disbursements from the State
  11. All construction testing results
  12. All resident inspector or engineer logs or records
  13. All approved shop drawings, manufacturer's manuals, and warranties and bonds
  14. All as-built drawings
  15. All required permits
  16. All progress meeting reports
  17. Construction progress schedule and all updates
  18. All project correspondence
  19. Staffing information
  20. Operation and maintenance manual and approval information (if applicable)
  21. Initiation of operation information
  22. Project accounting records
  23. Other information
- B. Project records should be retained by a loan recipient for a period of three years from the date of the administrative completion letter. Project files are subject to examination by the Michigan Municipal Bond Authority or the DEQ.

# Attachment A

## GUIDANCE ON RETAINAGE

Public Act 524 took effect January 1, 1983, and regulates the retainage of payments on construction contracts with public agencies. This Act states that if the public agency chooses to retain funds, the funds must be deposited in an interest bearing account for the contractor. The Act also states that a public agency **is not** required to deposit retained funds in an interest bearing account **if** the retained funds are to be provided under a **state or federal grant** and the retained funds have **not** been paid to the public agency.

The question has been raised over the years as to whether or not a public agency has the option of **not** depositing retained funds in an interest bearing account if the retained funds are to be provided under a SRF/DWRF loan AND the funds are not requested for disbursement. Under our loan programs, any funds drawn from a loan, including retainage, are subject immediately to our interest rates. Consequently, in order to avoid the earlier interest charges, some communities have opted not to request the retainage in a disbursement request until it actually needs to be paid to the contractor. However, this action also has caused disputes from contractors who believe that their retained monies should have been drawn and deposited into an interest bearing account.

Unfortunately, Act 524 is subject to more than one interpretation. The Act exempts projects using state or federal **grants** from the requirement to deposit retained funds into an interest bearing account. It is silent on the applicability of this option to state or federal **loans** (subsidized by federal grants). Consequently, it is difficult to render an interpretation of this Act that would have sufficient validity to withstand a legal challenge.

While the decision is yours, communities and consultants should consider the impacts of how they may choose to handle retainage. The fostering of a good working relationship with your contractor may outweigh any monetary benefits derived from deferring retainage draws. Whatever option you choose to implement should be discussed with your contractor at the preconstruction meeting.

## Attachment B

### CONSTRUCTION CONTRACTS WITH CERTAIN PUBLIC AGENCIES

#### Act 524 of 1980

AN ACT to provide for the terms of certain construction contracts with certain public agencies; to regulate the payment and retainage of payments on construction contracts with certain public agencies; and to provide for the resolution of certain disputes.

*The People of the State of Michigan enact:*

#### **125.1561 Definitions.**

As used in this act:

- (a) “Agent” means the person or persons agreed to or selected by the contractor and the public agency pursuant to section 4(2).
- (b) “Architect or professional engineer” means an architect or professional engineer licensed under Act No. 299 of the Public Acts of 1980, being sections 339.101 to 339.2601 of the Michigan Compiled Laws, and designated by a public agency in a construction contract to recommend progress payments.
- (c) “Construction contract” or “contract” means a written agreement between a contractor and a public agency for the construction, alteration, demolition, or repair of a facility, other than a contract having a dollar value of less than \$30,000.00 or a contract that provides for 3 or fewer payments.
- (d) “Contract documents” means the construction contract; instructions to bidders; proposal; conditions of the contract; performance bond; labor and material bond; drawings; specifications; all addenda issued before execution of the construction contract and all modifications issued subsequently.
- (e) “Contractor” means an individual, sole proprietorship, partnership, corporation, or joint venture that is a party to a construction contract with a public agency.
- (f) “Facility” means a building, utility, road, street, boulevard, parkway, bridge, ditch, drain, levee, dike, sewer, park, playground, or other structure or work that is paid for with public funds or a special assessment.
- (g) “Progress payment” means a payment by a public agency to a contractor for work in place under the terms of a construction contract.
- (h) “Public agency” means this state, or a county, city, township, village, assessment district, or other political subdivision, corporation, commission, agency, or authority created by law. However, public agency does not include the state transportation department, a school district, junior or community college, the Michigan state housing development authority created in Act No. 346 of the Public Acts of 1966, as amended, being sections 125.1401 to 125.1496 of the Michigan Compiled Laws, and a municipal electric utility or agency. “Assessment district” means the real property within a distinct area upon which special assessments are levied or

imposed for the construction, reconstruction, betterment, replacement, or repair of a facility to be paid for by funds derived from those special assessments imposed or levied on the benefited real property.

(i) "Retainage" or "retained funds" means the amount withheld from a progress payment to a contractor pursuant to section 3.

**125.1562 Construction contract; designation of person to submit written requests for progress payments; designation of person to whom requests for progress payments to be submitted; manner and times of submissions; deferring the processing of progress payments; payment of requested progress payment; failure of public agency to make timely progress payment; interest.**

(1) The construction contract shall designate a person representing the contractor who will submit written requests for progress payments, and a person representing the public agency to whom request for progress payments are to be submitted. The written requests for progress payments shall be submitted to the designated person in a manner and at such times as provided in the construction contract.

(2) The processing of progress payments by the public agency may be deferred by the public agency until work having a prior sequence, as provided in the contract documents, is in place and is approved.

(3) Each progress payment requested, including reasonable interest if requested under subsection (4), shall be paid within 1 of the following time periods, whichever is later:

(a) Thirty days after the architect or professional engineer has certified to the public agency that work is in place in the portion of the facility covered by the applicable request for payment in accordance with the contract documents.

(b) Fifteen days after the public agency has received the funds with which to make the progress payment from a department or agency of the federal or state government, if any funds are to come from either of those sources.

(4) Upon failure of a public agency to make a timely progress payment pursuant to this section, the person designated to submit requests for progress payments may include reasonable interest on amounts past due in the next request for payment.

**125.1563 Retaining portion of each progress payment to assure proper performance of construction contract; retainage; limitations; exceeding pro rata share of public agency's matching requirement; commingling and deposit of retained funds; releasing to contractor retainage and interest earned on retainage; irrevocable letter of credit.**

(1) To assure proper performance of a construction contract by the contractor, a public agency may retain a portion of each progress payment otherwise due as provided in this section.

(2) The retainage shall be limited to the following:

(a) Not more than 10% of the dollar value of all work in place until work is 50% in place.

(b) After the work is 50% in place, additional retainage shall not be withheld unless the public agency determines that the contractor is not making satisfactory progress, or for other specific cause relating to the contractor's performance under the contract. If the public agency so determines, the public agency may retain not more than 10% of the dollar value of work more than 50% in place.

(3) The retained funds shall not exceed the pro rata share of the public agency's matching requirement under the construction contract and shall not be commingled with other funds of the public agency and shall be deposited in an interest bearing account in a regulated financial institution in this state wherein all such retained funds are kept by the public agency which shall account for both retainage and interest on each construction contract separately. A public agency is not required to deposit retained funds in an interest bearing account if the retained funds are to be provided under a state or federal grant and the retained funds have not been paid to the public agency.

(4) Except as provided in section 4(7) and (8), retainage and interest earned on retainage shall be released to a contractor together with the final progress payment.

(5) At any time after 94% of work under the contract is in place and at the request of the original contractor, the public agency shall release the retainage plus interest to the original contractor only if the original contractor provides to the public agency an irrevocable letter of credit in the amount of the retainage plus interest, issued by a bank authorized to do business in this state, containing terms mutually acceptable to the contractor and the public agency.

**125.1564 Construction contract; agreement to submit matters described in subsection (3) to decision of agent; designation of agent; dispute resolution process; use; agent to receive pertinent information and provide opportunity for informal meeting; decision of agent to be final and binding; vacation of decision by circuit court; dispute resolution resulting in decision; final progress payment to original contractor where public agency contracts with subsequent contractor.**

(1) The construction contract shall contain an agreement to submit those matters described in subsection (3) to the decision of an agent at the option of the public agency.

(2) If a dispute regarding a matter described in subsection (3) arises, the contractor and the public agency shall designate an agent who has background, training, and experience in the construction of facilities similar to that which is the subject of the contract, as follows:

(a) In an agreement reached within 10 days after a dispute arises.

(b) If an agreement cannot be reached within 10 days after a dispute arises, the public agency shall designate an agent who has background, training, and experience in the construction of facilities similar to that which is the subject of the contract and who is not an employee of the agency.

(3) The public agency may request dispute resolution by the agent regarding the following:

(a) At any time during the term of the contract, to determine whether there has been a delay for reasons that were within the control of the contractor, and the period of time that delay has been caused, continued, or aggravated by actions of the contractor.

(b) At any time after 94% of work under the contract is in place, whether there has been an unacceptable delay by the contractor in the performance of the remaining 6% of work under the contract. The agent shall consider the terms of the contract and the procedures normally followed in the industry and shall determine whether the delay was for failure to follow reasonable and prudent practices in the industry for completion of the project.

(4) This dispute resolution process shall be used only for the purpose of determining the rights of the parties to retained funds and interest earned on retained funds and is not intended to alter, abrogate, or limit any rights with respect to remedies that are available to enforce or compel performance of the terms of the contract by either party.

(5) The agent may request and shall receive all pertinent information from the parties and shall provide an opportunity for an informal meeting to receive comments, documents, and other relevant information in order to resolve the dispute. The agent shall determine the time, place, and procedure for the informal meeting. A written decision and reasons for the decision shall be given to the parties within 14 days after the meeting.

(6) The decision of the agent shall be final and binding upon all parties. Upon application of either party, the decision of the agent may be vacated by order of the circuit court only upon a finding by the court that the decision was procured by fraud, duress, or other illegal means.

(7) If the dispute resolution results in a decision:

(a) That there has been a delay as described in subsection (3)(a), all interest earned on retained funds during the period of delay shall become the property of the public agency.

(b) That there has been unacceptable delay as described in subsection (3)(b), the public agency may contract with a subsequent contractor to complete the remaining 6% of work under the contract, and interest earned on retained funds shall become the property of the public agency. A subsequent contractor under this subdivision shall be paid by the public agency from the following sources until each source is depleted, in the order listed below:

(i) The dollar value of the original contract, less the dollar value of funds already paid to the original contractor and the dollar value of work in place for which the original contractor has not received payment.

(ii) Retainage from the original contractor, or funds made available under a letter of credit provided under section 3(5).

(iii) Interest earned on retainage from the original contractor, or funds made available under a letter of credit provided under section 3(5).

(8) If the public agency contracts with a subsequent contractor as provided in subsection (7)(b), the final progress payment shall be payable to the original contractor within the time period specified in section 2(3). The amount of the final progress payment to the original contractor shall not include interest earned on retained funds. The public agency may deduct from the final progress payment all expenses of contracting with the subsequent contractor. This act shall not impair the right of the public agency to bring an action or to otherwise enforce a performance bond to complete work under a construction contract.

**125.1565 Construction contracts to which act applicable.**

(1) Except as provided in subsection (2), this act shall apply only to a construction contract entered into after the effective date of this act.

(2) For a construction contract entered into before the effective date of this act, the provisions of this act may be implemented by a public agency, through a contract amendment, upon the written request of the contractor, with such consideration as the public agency considers adequate.