

MINNESOTA CONTRACTOR RECOVERY FUND REPORT, 2011



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Program Report

Contractor Recovery Fund, 1995-2011

Introduction

The Minnesota Legislature created what is now known as the Contractor Recovery Fund (CRF) in 1974. Amendments to the program were made in 2000 and again in 2007. The current program is administered by the Minnesota Department of Labor and Industry (DLI) under Minnesota Statutes §326B.89 (Supp. 2011).

The fund compensates homeowners and lessees of Minnesota residential property who have experienced direct out-of-pocket losses as a result of the deceptive actions or the non-performance of a Minnesota licensed residential contractor. Homeowners who suffer losses due to the actions of unlicensed subcontractors or material suppliers are not eligible for CRF reimbursement.

DLI administers the fund as part of its role in licensing residential building contractors, remodelers, roofers and manufactured home installers. Licenses are required for all residential building contractors and residential remodelers who contract with a homeowner to construct or improve dwellings by offering more than one special skill. Certain standards of education and professional conduct are required to be maintained to obtain and retain a license.

The CRF is funded through the collection of fees from each licensed residential building contractor in Minnesota at the time of licensure or renewal. These fees are paid into the state treasury to fund the CRF. In 2011, the CRF fee collected for a two-year license, ranged from \$470 to \$670 depending upon the gross business receipts of the licensee¹. The 2011 fee structure is shown in Table 1.

Annual gross receipts	Contractor Recovery Fund fee
Less than \$1 million	\$470
\$1 million to \$5 million	\$570
More than \$5 million	\$670

Table 1: 2011 Residential contractor license fees, including the 2010 surcharge

During fiscal years 2007 to 2011, more than 98 percent of the fund's revenues came from license fees. These other sources of revenue for the fund consist of interest earned and repayments collected from contractors. Contractor repayments to the CRF averaged \$16,778 a year during the same period. These repayments were for the fund's claims

¹ The two-year licensure fee was \$100, \$150, and \$200, dependent upon categorization as outlined in Table 1, in 2001. A \$150 surcharge was added in 2010.

payouts to homeowners or lessees, which were less than 0.2 percent of payouts. Revenue generated from interest earned has averaged about 1 percent annually. CRF fees collected and total revenues during FY 2007 to 2011 are shown in Figure 1.

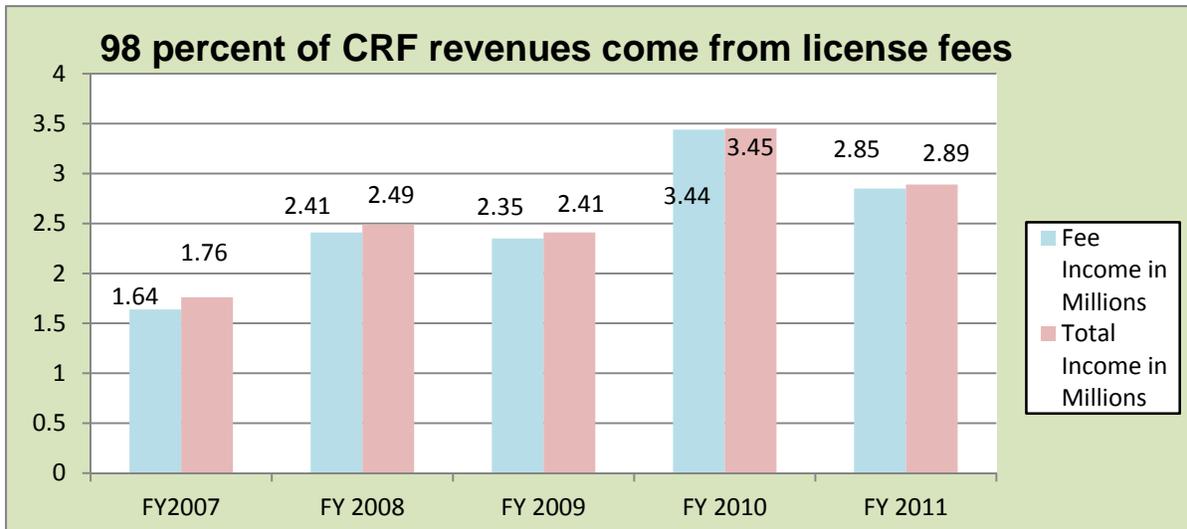


Figure 1: Contractor Recovery Fund revenues in millions, FY 2007 to 2011

From these collected fees, the CRF pays compensation to the homeowners or lessees who have sought and are eligible to receive compensation by statute (Minn. Stat. §326B.89 (2010) and §326.975 (2006)). Homeowners and lessees must have obtained a court-ordered judgment based on a claim of fraudulent, deceptive, dishonest practices, conversion of funds, or failure of performance that arose directly out of the transaction to apply to the CRF for loss compensation. Once a homeowner or lessee’s application for compensation is received and all supporting documentation is provided, DLI staff members carefully review the material. Then, based upon the CFR statute, staff makes a determination as to the “approved amount” of the compensable loss the homeowner or lessee suffered.

There are two ways an applicant may to file a claim with the CRF. One is an accelerated procedure, which is available when the homeowner or lessee’s claim for compensation is for \$7,500 or less and the contractor license set aside has not reached the \$50,000 statutory limit². The second is a standard procedure for compensation, which is for applicants who apply for more than \$7,500 or who are otherwise not eligible to apply for compensation under the accelerated procedure.

Since 1994, the Legislature has increased the limitations of the amount of compensation a homeowner or lessee can recover from the CRF. As outlined in Table 2 below, there has been an increase in: the dollar amount applicants may seek in compensation, the upper

² Each licensed residential contractor has \$50,000 of the CRF set aside to pay claims under the accelerated procedure. Once claims totaling \$50,000 for each licensee have been made under the accelerated procedure, the homeowner must then use the standard procedure.

limit on the amount CRF can pay in compensation for each contractor license and the set asides for the accelerated claims process.

	1994 to 2000	2001 to 2006	2007 to 10/11/2011
Maximum homeowner or lessee claim per incident	\$50,000	\$50,000	\$75,000
Maximum CRF payout per contractor license	\$50,000	\$75,000	\$150,000
Maximum dollar amount per contractor set aside for the accelerated claim process	N/A	\$15,000	\$50,000

Table 2: Contractor Recovery Fund payments to homeowners or lessees, FY 1994 to 2011

Administrative operating costs have averaged 6.25 percent annually for the CRF and are shown in Figure 2. Currently, administrative operating costs are at a historically low level. Operating costs are not available for FY 2007.

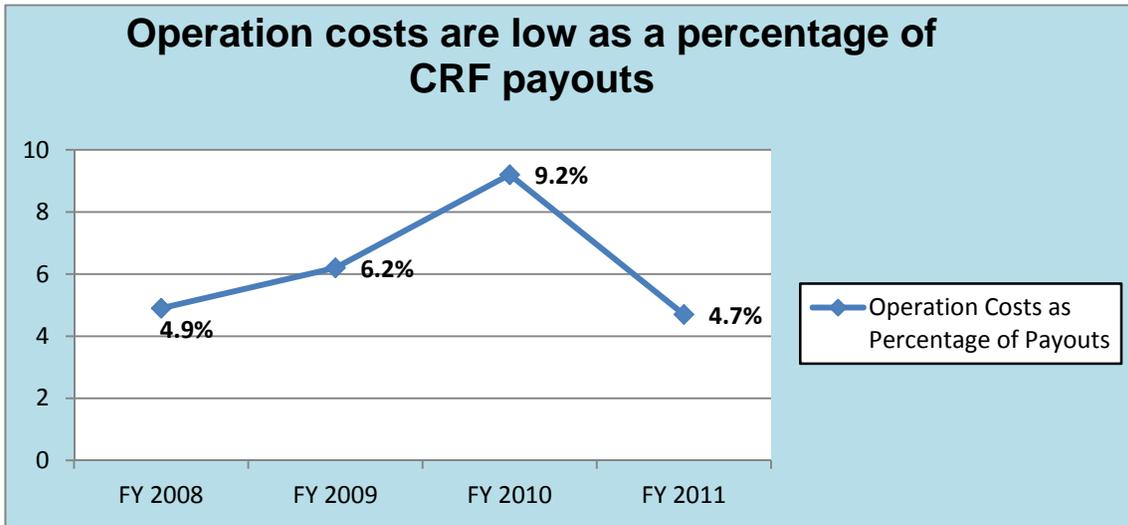


Figure 2: Operation costs as a percentage of CRF payouts

Methodology

This report uses data provided by DLI’s Construction Codes and Licensing Division, including the CRF administrator and the DLI Financial Services unit. In all cases, statistics were gathered based upon calendar years unless otherwise noted. As a general rule, revenue statistics are reported in fiscal years. When comparing aggregate totals between periods, both the 1995 to 2000 and 2001 to 2006 periods encompass six calendar years, while the 2007 to 2011 period contains only five calendar years, since the 2011 data is not yet complete. Table 3 in the Appendix provides a synopsis of the data examined during the three periods.

Three period comparisons: 1995 to 2000, 2001 to 2006 and 2007 to 2011

Contractor payments of CRF claims have declined

When the CRF processes a claim for compensation, it notifies the contractor in order to allow the contractor an opportunity to pay the claim. Contractor paid claims fall into one of two categories, either the contractor reimburses the CRF for the amount paid or the

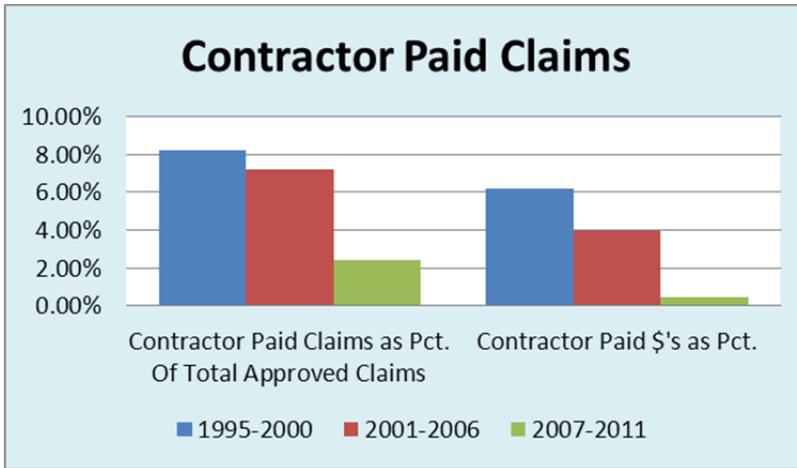


Figure 3: Number of contractor paid or reimbursed claims as a percentage of total approved claims contrasted with the total contractor paid dollars as a percentage of total approved dollars.

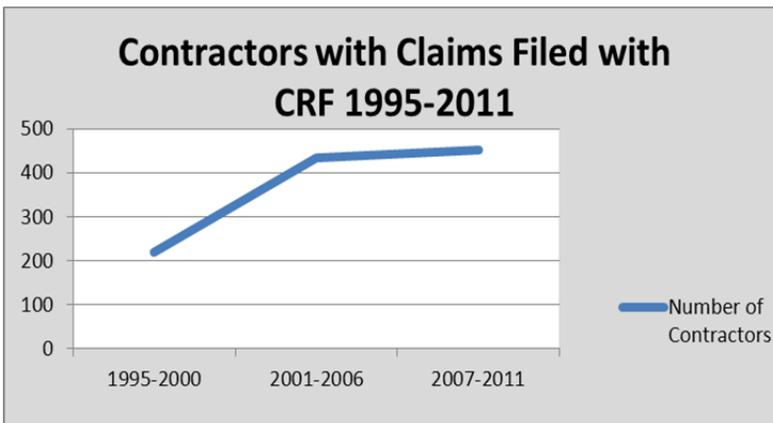


Figure 4: The number of contractors with CRF claims filed by homeowners or lessees

during the period studied, fewer claims are being satisfied directly by contractors and the size of the payments made are declining. At the same time, the number of contractors having claims filed against them with the CRF increased from 220 in the 1995 to 2000

contractor directly pays the court-ordered judgment after the claim is filed with the CRF³.

Between the periods 1995 and 2011, there has been a dramatic decline in the percentage of claims paid by contractors. In the 1995 to 2000 period, 8 percent of all claims were paid by contractors. In the 2001 to 2006 period, 7.2 percent of all claims were paid by contractors. By the 2007 to 2011 period, that

percentage had fallen to 2.4 percent. Additionally, the average size of the contractor payment made, \$6,259, or 6.2 percent of total approved dollars in the 1995 to 2000 period decreased to \$3,847, or 0.5 percent of total approved dollars, in the 2007 to 2011 period. In short,

³ Statutory incentive for the contractor to pay the claim is provide for by Minnesota Statutes §3268.84 (9) (2010). That statute allows DLI to take enforcement action against a contractor's license if the licensee engages in any act or practice that results in compensation paid to a homeowner/lessee from the CRF.

period to 434 in the 2001 to 2006 period and 452 during the 2007 to 2011 period (see figure 4).

Both the quantity of CRF claims and the total dollars claimed have increased

The total annual number of claims has increased from the initial period of 1995 to 2000, 81 claims annually, to the two succeeding periods 2001 to 2006 and 2007 to 2011, 177 and 158 claims respectively. Between the periods 1995 to 2000 and 2007 to 2011, the average requested claim amount has increased from \$11,043 to a requested claim of \$31,082, a 181 percent increase⁴. The average approved amount of claims has kept pace with this increased requested claim amount, growing from \$6,837 in 1995 to \$19,136 in 2007, a similar 180 percent increase. The total amounts paid out by the CRF are not

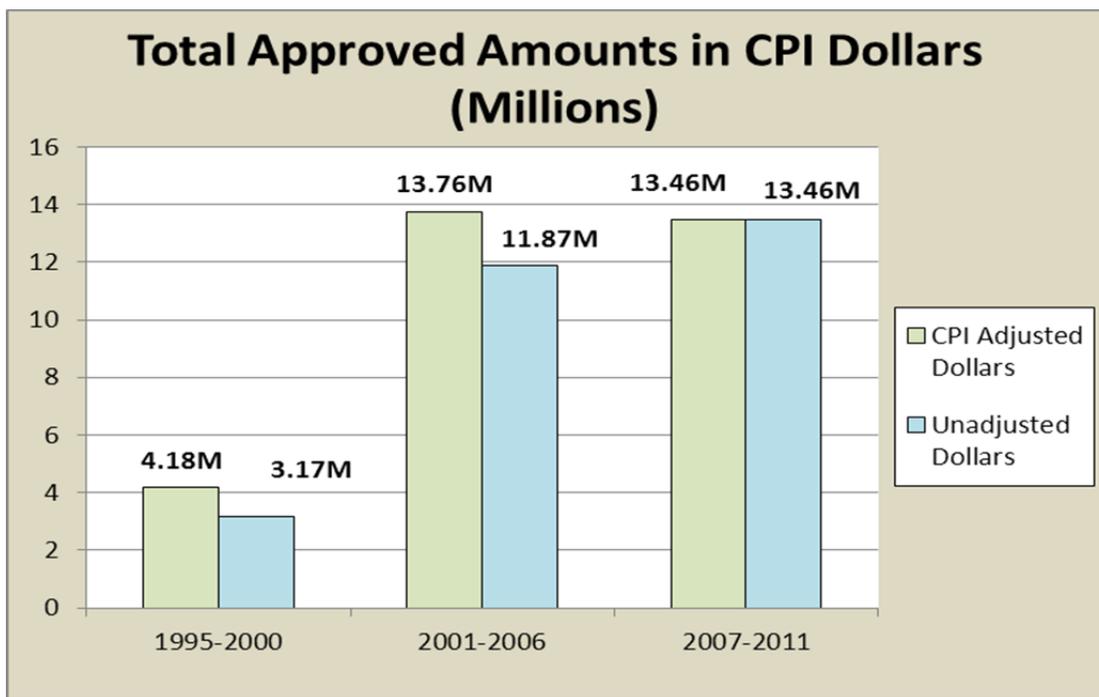


Figure 5: Total approved claim dollars in millions adjusted for inflation for the three periods

available prior to 2007, hence the reliance on approved amounts in this study. However, by using the CRF approved amounts adjusted for inflation⁵ during the three periods of the CRF, the approved amounts have remained fairly steady since 2001 (see Figure 5).

Contractor license limit payouts decline

The Minnesota Legislature has set a limit on the amount of compensation that can be paid by the CRF for judgments against each individual contractor, see Table 2. Claims which

⁴ One 1998 dollar, adjusted by the Consumer Price Index (CPI) (the midpoints of the ranges) is \$1.16 for 2004 and \$1.32 for 2009.

⁵ Figure 5 adjusts approved dollars for the CPI by the mid-year point of the three periods.

have been filed against licensed contractors where this “contractor license limit” (\$75,000 in 2001-06, \$150,000 in 2007-11) was reached, decreased from 38.3 percent of claims in 2001 to 2006 to 10.1 percent of claims in 2007 to 2011. It should be expected that the present period’s percentage of claims denied due to the upper contractor license limit being reached will rise slightly due to the inherent time lag of the system, but it is difficult to see it matching the 2001 to 2006 level of 38 percent.

Pressures on the CRF are the result of three factors: the number of approved claims against the fund; the average amount of those claims; and the revenues generated by license fees. The percentage of homeowner or lessee claims being denied due to reaching the upper contractor license limit is one measure of the consumer protection function which the CRF affords. It is not clear whether increasing the contractor license limit has the same long-term effect as adding interstate lanes for traffic (increased number of lanes leads to increased traffic volumes) where the number of claims against individual contractors simply increase to match the new claim limits. However, the early evidence does not support this hypothesis. Claims denied due to the upper contractor license limit being reached declined from 13.9 percent of total cases in the 1995 to 2000 period to 4.7 percent in the 2007 to 2011 period and although the numbers of claims were small, there were no denials due to licensure limits in FY2011.

The 2007 to 2011 years

The 2007 to 2011 period was heavily impacted by the post 2005 collapse of the real-estate market across the nation. Minnesota was not exempted from the housing bubble and its impacts are shown in the following pages.

The most recent calendar year of 2011 appears to be something of an anomaly. While the

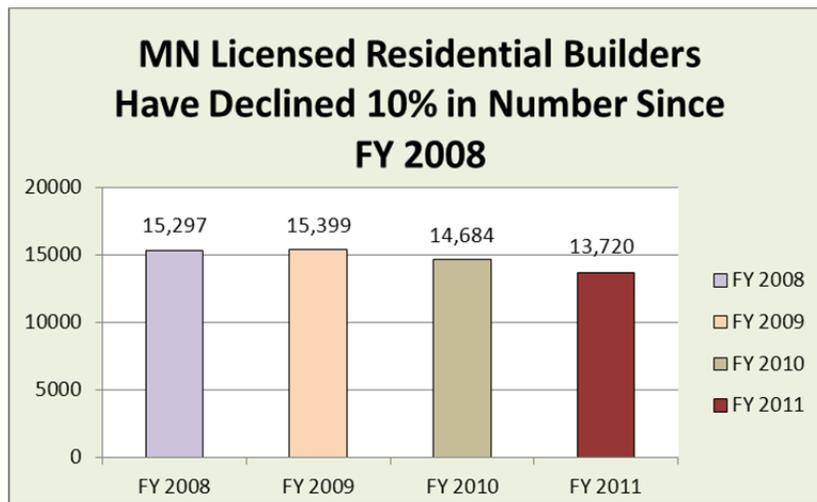


Figure 6: Number of licensed residential builders in Minnesota

compilation and analysis of the 2011 claim data is still not complete, the total number of claims is markedly lower compared to the preceding two years. Minnesota, as seen in Figure 6, has experienced a decline in the number of licensed residential contractors since 2009, and a significant 41 percent decline, in the

average requested amount of compensation by homeowners or lessees (see Figure 7). This decline was attributed by CRF staff to an increase in the number of claims

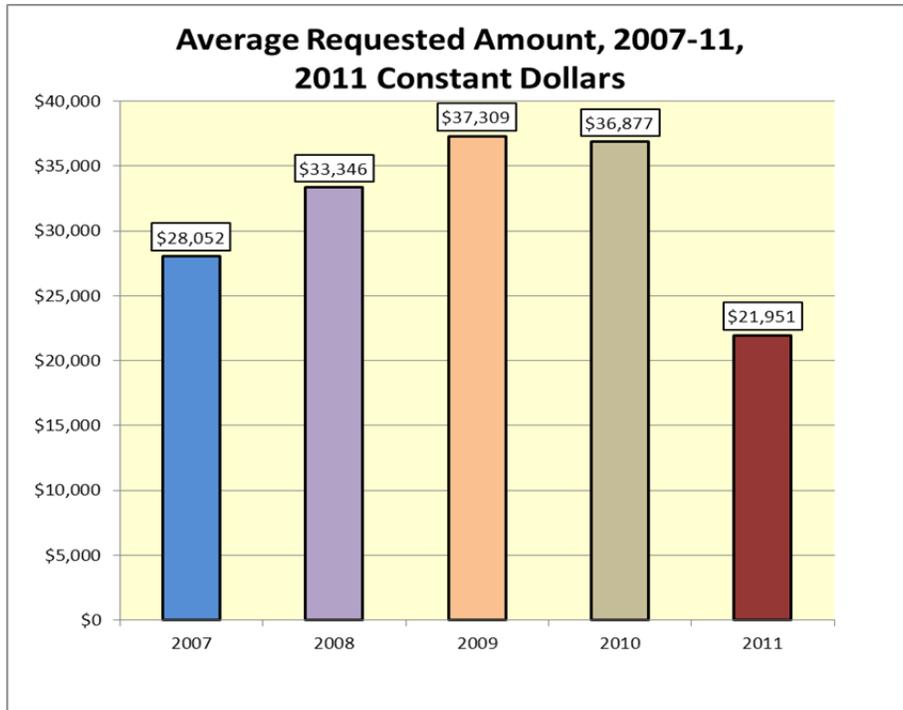


Figure 7: Average requested CRF claim amount, CY 2007-2011⁶

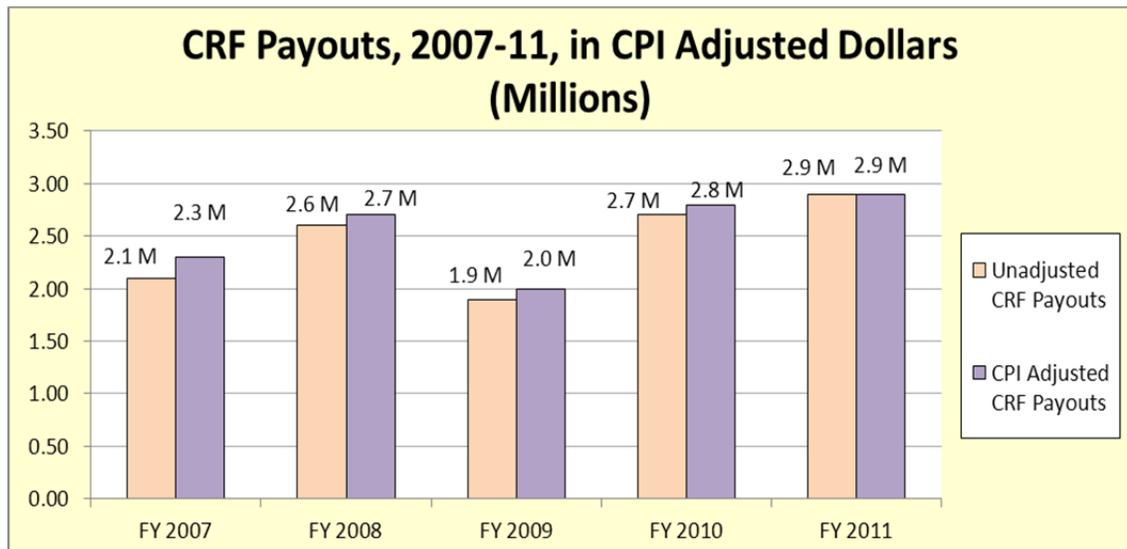


Figure 8: Contractor Recovery Fund payments to homeowners or lessees, FY 2007 to 2011

in 2011 where down payments for work were accepted but the work was not performed by the contractor. Average requested amounts by homeowners or lessees in **unadjusted**

⁶ The average homeowner or lessee requested amounts of compensation were calculated using the CRF DLI database.

dollars were \$25,808 in 2007, \$31,679 in 2008, \$35,444 in 2009, and \$35,402 in 2010. The average **adjusted** requested amount by calendar year is shown in Figure 7. The number of residential builders who have had claims made against them in the CRF has also declined from an average of 115 in the preceding four calendar years to 67 through October 2011.

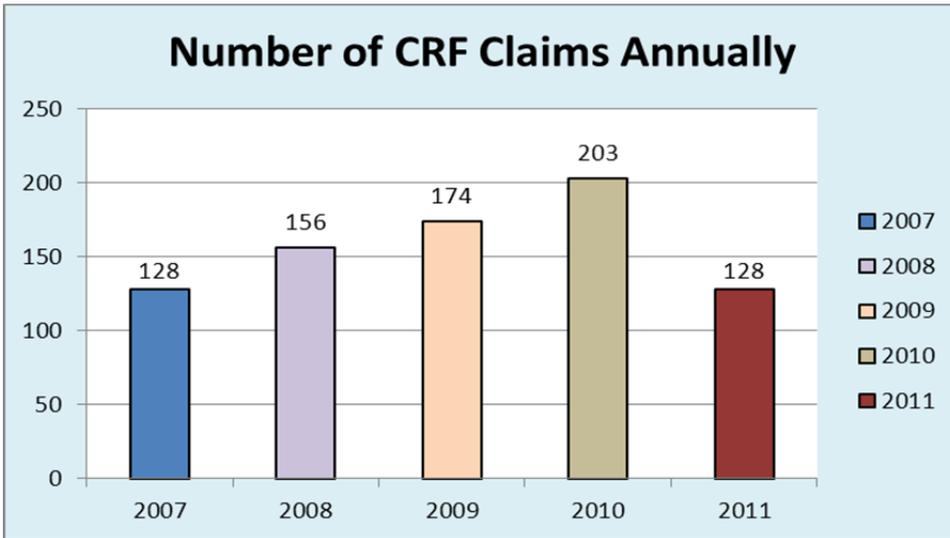


Figure 9: Annual number of CRF claims, 2007 through October 2011

Claims where the residential builder’s upper license limit was reached have declined yearly, from 30.5 percent in 2007, to 14.7 percent in 2008, to 0 percent in CY 2009 and CY 2010. There are no license limit denials expected in CY 2011. Figure 8 shows CRF

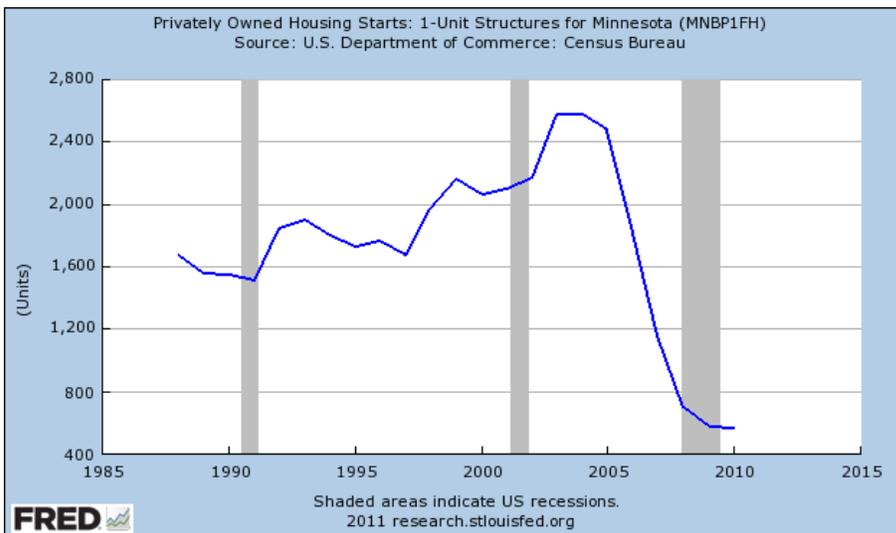


Figure 10: Single-family housing starts in Minnesota

payouts by fiscal years, in both CPI adjusted and unadjusted dollars. There has been a steady growth in the total number of cases throughout this period, with the exception of

2011 to date, as illustrated in Figure 9. This may have been expected by the pressures created by the 2005 decline of housing values⁷ (see Figure 10).

Cases where contractors have paid the claim have continued to decline during the 2007 to 2011 period with a high of seven paid claims in 2008, declining to two claims paid in 2009 and 2010, and one paid claim in 2011 to date. Total dollars paid by contractors with claims filed against them using the CRF have been below \$10,000 annually the past three years.

It is important to emphasize and restate the dramatic effect the housing value decline had on the Contractor Recovery Fund. The chart⁸ in Figure 10 illustrates the dramatic decline in construction of Minnesota single family homes during the CRF's history.

The average sales price of a new single-family home sold in 2010 was \$272,900. For comparison purposes, the average sales price⁹ was \$270,900 in 2009, \$292,600 in 2008 and \$313,600 in 2007. This decline in housing values would affect the average requested amount from CRF, since the higher the home's cost the higher the potential loss. Housing activity as measured by building permit issuance plateaued in 2010 after having shrunk 74%, from 7.3 per thousand residents to 1.9 per thousand residents, between 2005 and 2009.¹⁰ Craig Kamman, a Minnesota realtor and writer stated, "Recently we have seen increased (building) activity but we are still down for 2011 and it is looking like we may end up lower than 2010."¹¹

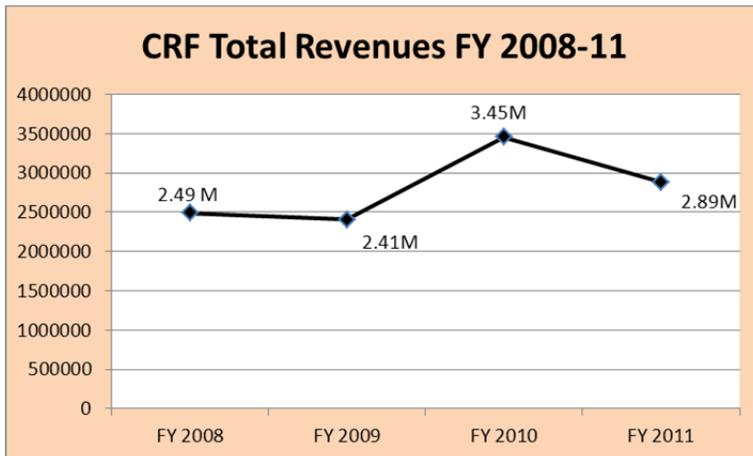


Figure 1: CRF revenues in millions, FY 2008 to 2011

Following the beginning of the market collapse in 2005 to 2006, DLI saw increasing CRF claims from 2007 through calendar year 2010, increasing average requested amounts from homeowners for compensation from 2007 to 2009 with only a small moderation in 2010 and a steep decline in 2011, and a decline in the number of residential builder licenses

issued throughout the 2007 to 2011 period. CRF revenues are shown in Figure 11.

⁷ Residential builders make up the bulk of CRF claims at 97 percent; residential remodelers make up the remaining 3 percent. Residential builders, besides remodeling and contracted new home construction, often are involved in building on speculation, investing funds in home lots, and participating in sub-developments. All of these activities were negatively affected by the housing bubble collapse, placing often unsustainable pressures on residential contractors.

⁸ St. Louis Federal Reserve, Research, [http://research.stlouisfed.org/fred2/graph/?chart_type=bar&s\[1\]\[id\]=MNBPIFH](http://research.stlouisfed.org/fred2/graph/?chart_type=bar&s[1][id]=MNBPIFH)

⁹ U.S. Census Bureau, <http://www.census.gov/construction/chars/highlights.html>.

¹⁰ "Twin Cities Residential Construction: Glimmers of Hope in 2010," Metro Stats, Baris Gumus-Dawes and Libby Starling, Metropolitan Council Research, http://stats.metc.state.mn.us/stats/pdf/ResidentialConstruction_MS2010.pdf

¹¹ Craig Kamman, "Minneapolis / St Paul Building Permits up for Sept", Oct. 27, 2011, <http://www.craigkamman.com/2011/10/27/minneapolis-st-paul-building-permits-up-for-sept-2011/>

The apparent FY 2010 bump in receipts is a result of the \$150 surcharge (\$75 annually) on two-year license renewals imposed by DLI pursuant to Minn. Statutes §326B.89, subd. 16 (2010). The major factor in the decline of revenues between FY 2010 and FY 2011 is the number of residential builders declined by 6.5 percent. Another contributing factor is that the CRF portion of the license fees is determined by the gross annual receipts of the residential builder during the previous year. As residential builders' annual receipts decline, so does the licensing fee collected under the CRF program, see Table 1.

CRF claims are separated into two groups for purposes of payment. One payment is made in June for all claims made in the previous calendar year for contractor failures that occurred before December. The second payment is made in November for all claims made in the previous fiscal year for contractor failures that occurred on or after Dec. 1.

The bulk of revenues to the CRF are realized in January through March during the residential contractor renewal period. As of Dec. 30, 2011, the fund balance is estimated to be \$2.8 million by April 2012. The projected total claim payments for CY 2012 (June and November) are \$2,303,000 based on current estimates that include increases in fiscal year payouts and decreases in calendar year payouts.

Conclusion

Roughly a two-year time lag occurs from the time homeowners or lessees of Minnesota residential property have experienced a direct out-of-pocket loss as a result of the deceptive actions or the non-performance of a Minnesota licensed residential contractor to the closure of a claim with the CRF. The majority of this time is spent in obtaining a district court-ordered judgment.

Because of this time lag, the CRF is experiencing the effects of what occurred in the housing market two years previously (2009) on payouts (*see Figure 10*). As a result, the amounts of payouts are likely to stay fairly consistent in the next two years as the housing market has been fairly steady during the past two years, "bouncing along the bottom" as a Federal Reserve Bulletin described the market. CRF revenues, on the other hand, are much more responsive to market demand for housing stock. As demand has decreased, fewer residential builders have acquired licenses, decreasing the CRF revenues available to pay claims.

Appendix - Contractor Recovery Funds 1995-2011, Table 3

	1995 thru 2000	2001 thru 2006	2007 to 10-11-2011
Total Cases	490	1060	790
Annual Average Number of Cases	82	177	132
Total Number of Denials	72	139	37
Denials as Pct. of Total Cases	13.9 %	13.1 %	4.7 %
Cases with Complete Data	490	716	567
Cases where CRF Funds Exhausted	150	406	80
Cases Where CRF Funds Exhausted as Pct.	30.6 %	38.3 %	10.1 %
Average Requested Amount (All Cases)	\$11,043	\$14,075 (\$12,418)†	\$31,082 (\$14,547)†
Average Approved Amount Excluding Denials	\$8,009	\$13,072 (\$8,650)†	\$20,609 (\$10,133)†
Average Approved Amount (All Cases)	\$6,837	\$11,357	\$19,136
Contractor Paid Claims	39	76	19
Contractor Paid Claims as Pct.	8.0 %	7.2 %	2.4 %
Total Contractor Paid \$'s	\$195,150	\$475,655	\$73,098
Average Contractor Paid Claim Size	\$5,004	\$6,259	\$3,847
Total Fund Approved \$'s *	\$3,168,832	\$11,868,000	\$13,465,298

	1995 thru 2000	2001 thru 2006	2007 to 10-11-2011
Total Contractor Paid \$'s as Pct.	6.2 %	4.0 %	0.5 %
Total Number of Contractors	220	434	452
Average Cases per Contractor	2.2	2.4	1.8

Table 3

* For cases with Complete Data

† Annual inflation rate 1995 to 2006 was 2.52 percent; annual inflation rate 2001 to 2010 was 2.43 percent

Data Source – DLI Contractor Recovery Fund

Acknowledgements

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