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more value, less risk

TBD Consultants

Bay Area Current Market Conditions – July 2017

We reported in December 2016 that the construction market in California had sailed through the General Election without a pause, and we again drew attention to the need to carry bidding contingency factors to cover the heated market. Since December 2016 we have not witnessed any slow down or pull back. The large projects, especially in the Bay Area and Northern California, continue to move forward (albeit some continue to move slowly through the approval process).

What are the factors that continue to drive the construction market:

1) Developers can find financing at historically low rates of interest and Banks have the liquidity to lend.

2) The Housing Market is buoyant and is still a big driver of the economy- Values continue to rise, albeit at various rates depending on the county. First time buyers can purchase their first home at still very attractive interest rates although raising necessary deposits is becoming harder.

3) Most of the subtrades are fully committed with work and can pick and choose the work they care to go after. General Contractors are struggling to find two or three interested bidders for major subtrades.

4) Lack of skilled tradesmen Subtrades find there is acute shortage of tradesman looking for work. More incentives have to be provided.

5) Salaries of GC supervisory staff are rising to attract or retain staff.

6) All sectors are busy. Accordingly Contractors will gravitate to sectors with less risk and higher profit margins.

7) In this economy, the public sector will struggle to attract competitive bids. The procurement process of favoring lump sum bids with many Bid Alternates will struggle to attract a competitive pool of General/Subs.

8) Schedules: In this economy it will be difficult to work to tight schedules. With Subs juggling many projects expect extended durations or delay.

9) Lumber prices are headed up due to the tariff on lumber from Canada. Steel tariffs may well be coming soon. None of the proposed tariffs will lower the cost of construction.

Escalation and TBD Index

The TBD index is published on our website www.tbdconsultants.com and monitors the in-place construction cost escalation for a simple new construction building.

For the period of 12 months ending January 2017 our TBD Cost index has shown an escalation rate of 8.96 %. Looking at the last few years the yearly escalation rates have been as follows:

Year 2010……….9.63%
Year 2011……...14.01%
Year 2012……….8.97%
Year 2013……….7.02%
Year 2014……….6.76%
Year 2015……….6.26%
Year 2016……….8.96%
Average……..….8.80%

Historically escalation has been in the 3.5-3.75% range. The last seven years however have averaged 8.8% per annum. This level of construction cost escalation is not sustainable in the long term. It does suggest a correction is overdue however and a careful monitoring of any signs of slowdown is warranted.

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Bidding Contingency

Following on our recommendations of December 2017, we again have looked at a broad band of public sector projects to advise clients on the percentage market factors and would recommend the following to be added to any estimate. These ranges are broad to cover the various added factors e.g. renovation, phasing, schedule, number of alternates, etc., which will have compounding effect on bidding response.

1) Projects in the $1m-$5M range
   Recommended Bidding factor 20-50%

2) Projects in the $5m-$10M range
   Recommended Bidding factor 20-35%

3) Projects in the $10m-$20M range
   Recommended Bidding factor 15-25%

4) Projects in the $20m-$50M range
   Recommended Bidding factor 10-15%

Again, we appreciate the duress of recommending to public clients of the need to account for the above factors. It is, however uncomfortable, a dialogue we need to continue to recommend.