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more value, less risk

TBD Consultants

Bay Area Current Market Conditions – January 2018

In mid-2017 we reported on factors driving the construction market forward. There was discussion at that time over the possible “bubble” we were in and when it might end. The stock market which is always an indicator has been on an upward trajectory, long enough to have all knowledgeable gurus predicting a significant correction (most considered equities to be overvalued). However there appears to be a “Goldilocks scenario” of above average growth and below average inflation. That portends the Stock Market bull run still has some legs especially now that the new Federal Tax Bill has passed.

The Bay Area construction market is humming along with record low unemployment.

The current factors that continue to drive the Bay Area construction market:

- 1) Areas close to San Francisco, which hitherto may have been moving at a slower pace, are now on the front burner e.g. Oakland is now a market that is very active.
- 2) Lack of competition especially at the subtrade level. All trades are very busy, however certain trades have been more troublesome than others including concrete, glazing, drywall, casework and MEP. Finding two or more bidders for each sub-trade is an ongoing challenge.
- 3) Lump Sum Bidding: In this market many contractors do not need to find work in the Lump Sum bidding world. There is an abundance of work they can negotiate in some form of GMP, often with Design/Build components. Profit margins are higher and risks lower than in the typical Lump Sum bidding world.

- 4) Lack of experienced construction personnel is becoming acute especially as the baby boomer generation retires. The current immigration crackdown may aggravate this shortage.
- 5) Schedules: In this economy it will be difficult to work to tight schedules. With Subcontractors at capacity and juggling many projects expect extended durations or delay.
- 6) Public sector projects: We can expect a relatively small number of bids even on new projects. Client should carry bidding contingencies on all projects with a heavier weighting on renovation.
- 7) Housing: The cost of renting or buying is a major impediment to attracting or retaining staff. Living in the outer periphery of the Bay Area and commuting is no longer attractive given the extended commute time and traffic congestion.
- 8) Material costs: Certain material cost have risen in the last year partly as a result of new tariffs and a weaker dollar. e.g. Lumber with double digit increases.

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.

Our TBD Cost Index has shown an escalation rate of 80% since the first quarter of 2010 through end of 2017 - that equates to an average annual escalation of 7.6% compounded over the last eight years.

Historically escalation has been in the 3.50% - 3.75% range. This current high level of construction cost escalation is not sustainable in the long term. It does suggest a correction is overdue, and careful monitoring is warranted. However, this coming year has started as the last year ended, and accordingly we expect this heated market to continue through 2018.

Bidding Contingency

Following on our recommendations of July 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 a compounding effect on bidding responses. As in our last Market Report we recommend the following bid contingencies:

- 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%

At this stage, most public clients are aware of the current heated market and the difficulty of obtaining competitive bidding. Even if bids from General Contractors are tightly grouped there is no guarantee the response from the sub-trades was competitive in nature. (or how many sub bids were received).