111 Pine Street
Suite 1315
San Francisco
CA 94111

415 981 9430
415 981 9434 fax
info@tbdconsultants.com

tbd consultants

more value, less risk

TBD Consultants

California /Bay Area Current Market Conditions – July 2018

In January 2018 we were speculating when this current cycle of expanded construction activity would start to ease or were we riding in a bubble about to burst.
The stock market has mostly taken a breather for most of the last six months although there is hope tax cuts and Governments probusiness regulations may still lend some confidence. However, on the tariff turmoil front the US is upping the stakes especially with China, creating uncertainty and impacting some construction materials pricing adversely e.g. Steel and Lumber. These price increases will certainly be passed along.
In a recent nationwide survey of 301 executives of large construction companies and design firms most believe the current construction market growth will extend into the latter part of 2019. (even if the bull market does not continue) Beyond that time frame the future is less certain. Going out three years the sentiment changes with the majority expecting market declines.

The California construction market remains buoyant especially the Bay Area along with record low unemployment despite any headwinds mentioned above.

The current factors that continue to drive the Bay Area construction market have not fundamentally changed in the last 6 months:

All the factors mentioned previously six months ago still apply:

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 more acute especially as the baby boomer generation retires. The current immigration crackdown has also possibly aggravated 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 not attractive either given the extended commute time and traffic congestion.

8) Material costs: Certain material costs have risen in the last year partly as a result of new tariffs and a weaker dollar. e.g. lumber with double digit increases, steel increases working their way through. Lately concrete price increases have been announced.

9) Modular construction: The current market is driving the need for modular off-site construction both for lower costs and speed of erection. These decisions need to be made early in design process. Any building type with repetitive units are good candidates e.g. housing, hotels, hospital bed wings

10) Wage rate increases: Wage rate increases are now catching up with market factors e. g. union labor increase recently promulgated to take effect June 2018, had the base rate increases of approximately 4.5-5%

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 85% since the first quarter of 2010 through second quarter 2018 - that equates to an average annual escalation of approximately 7.5% compounded over the last eight years. With recent tariffs working their way through the system we would expect escalation in 2018 to range between 7-8%.

This compares with historical escalation in the 3.5% - 3.75% range.

Bidding Contingency

The heated Bay Market of 2017 has continued into the first half of 2018. Bid results have reflected this heavily impacted market. In the public sector for new construction, costs of $1,000/SF and above are no longer the exception. This new high-water mark is giving clients pause and heart burn. (Post bid Value engineering is coming into paly to rescue projects even if that means redesign)

The need to identify and carry a bidding contingency is of critical importance with Value engineering always best implemented at the early stages of design.

Following on our previous recommendations, 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%

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).

.