111 Pine Street
Suite 1315
San Francisco
CA 94111

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

more value, less risk

TBD Consultants

California Current Market Conditions – January/February 2020

Our last report in August 2019 recapped the stock market coming close to all-time highs. Come end of December 2019 and the end of a decade, it is worth looking at the last ten years .The stock market has again reached new heights and the 2010s were the first decade without a bear market (defined as a 20% drop from any peak). Yes there were six 10% corrections, but none were bull market killers.

Trade wars remain a cause for uncertainty and anxiety for all sectors, however for the construction market it is just one more Risk factor to accommodate when agreeing to contract terms or estimating risk. On large projects it may be more cost effective not to place the risks related to trade wars on the contractors. In this heated climate, contractors will be conservative when pricing perceived trade war price fluctuations. Agreements to reimburse price fluctuation related to trade wars would be one option to eliminate this risk transfer.

In the US Construction Market there appears to be enough construction work in the pipeline to hold off recession fears for at least the coming 12 months. In addition, there is a strong possibility major funds will be released for Public Sector Infrastructure projects to add to the current volume of work.

California remains one of the hottest construction markets and will likely be one of the last states to experience a slowdown. All sectors are vibrant with all contractors searching for qualified staff to fulfill their commitments. This need for staff also applies to professional architects, engineers and other allied professionals.

California, like most states, has acute construction labor shortages. This problem has escalated over the last 10 years, and as more baby boomers retire the problems show no sign of abating.

Labor shortages have a major impact on the market climate including:

1) Limiting the number of bidders especially at the subtrade level
2) Contractors have become very selective on what projects to bid on and will avoid project delivery methods or locations not in their “wheelhouse”
3) Schedules- timelines need to accommodate longer durations
4) Delays- expect more delays as contractors juggle resources

Construction remains a high-risk sector where the bigger the project, the higher the inherent risks. P3 contracts on large projects have been the procurement of choice to assign risk from the client to the contractor with a fixed-price contract. However, due to heavy losses on past contracts this delivery method is less attractive to contractors.

Trends that will roll on in 2020 include:

1) Modular and panelized construction- More contractors are trying to take advantage of off-site modular and panelized construction
2) Surge pricing-after a major disaster e.g. wildfires
3) Increased insurance premiums will reflect the new perceived risks of environmental changes
4) Financing by Chinese overseas investors will be more problematic
5) Construction costs will continue to rise to reflect the market

Bidding Contingency

Below we have reiterated the comments from previous reports. In this volatile market we still recommend carrying a Bid Contingency separate from any other contingency for Design Development or Escalation Costs. We expect the current heated market conditions to extend for at least the next 12 months.

The level of Bidding Contingency previously recommended will vary depending on a number of risk related items. e.g. location, public or private, size of project, renovation or new construction, procurement methods.

Depending on the above factors, the recommended Bidding Contingency may vary from 0-50%. The small public sector renovation projects in difficult locations will be subject to the highest risk factors.

Escalation and Indices

California Construction Cost Index (CCCI) and TBD Bid Index

The TBD index is published on our website, [www.tbdconsultants.com,](http://www.tbdconsultants.com) and monitors the in-place construction cost escalation for a simple new construction building.

The CCCI index is derived from Engineering News Record (ENR) building cost indices (BCI) for San Francisco and Los Angeles. This index is compiled from a very limited basket of items (labor and materials) and is an **index based on raw costs only** and does not reflect current market conditions. Accordingly, this index moves very slowly and does not reflect upwards or downward swings due to market conditions. Nevertheless, many public agencies e.g. Community Colleges will tie their construction budgets to a set CCCI index and may only acknowledge a budget adjustment based on that index at bid time.

Given the heated market we have experienced forth last 10 years the CCCI has been unable to reflect the budget adjustments required by the real market conditions. Accordingly, the CCCI index has lagged the true market condition factors.

The TBD Bid Index (prepared by TBD Consultants) is an **index** which reflects **the market conditions** based on the unit rates for work in place and based on review and reconciliation of bids by contractors. This TBD Index is updated quarterly and is published on our website for reference by our clients or interested parties.

The following is a comparison chart by year back to 2014 to show the divergence in annual escalation between the two indices.

	2019	2018	2017	2016	2015	2014	TOTAL(Compounded)
CCCI Index	3.6%	1.3%	3.5%	4.4%	2.2%	1.3%	16.3%
TBD index	8.5%	5.0%	7.3%	9.7%	7.4%	5.0%	45.3%