

# **Advising Clients on Project Pricing and Bidding Volatility**

**Michael D. Dell'Isola, PE, CVS, FRICS**

**Senior Vice President  
Faithful + Gould  
2500 Maitland Center Pkwy  
Suite #311  
Maitland, FL 32751**

# What is Happening?

- Bids 10%, 20% and even 50% over budget
- Difficulty getting bidders
  - Prime contractors/construction managers
  - Subcontractors
- Difficulty getting materials and skilled labor
- Nationwide impact – almost all metropolitan areas
- Frustration
  - Owners
  - Designers
  - Construction/project managers
  - Constructors

# Factors Driving Price Increases

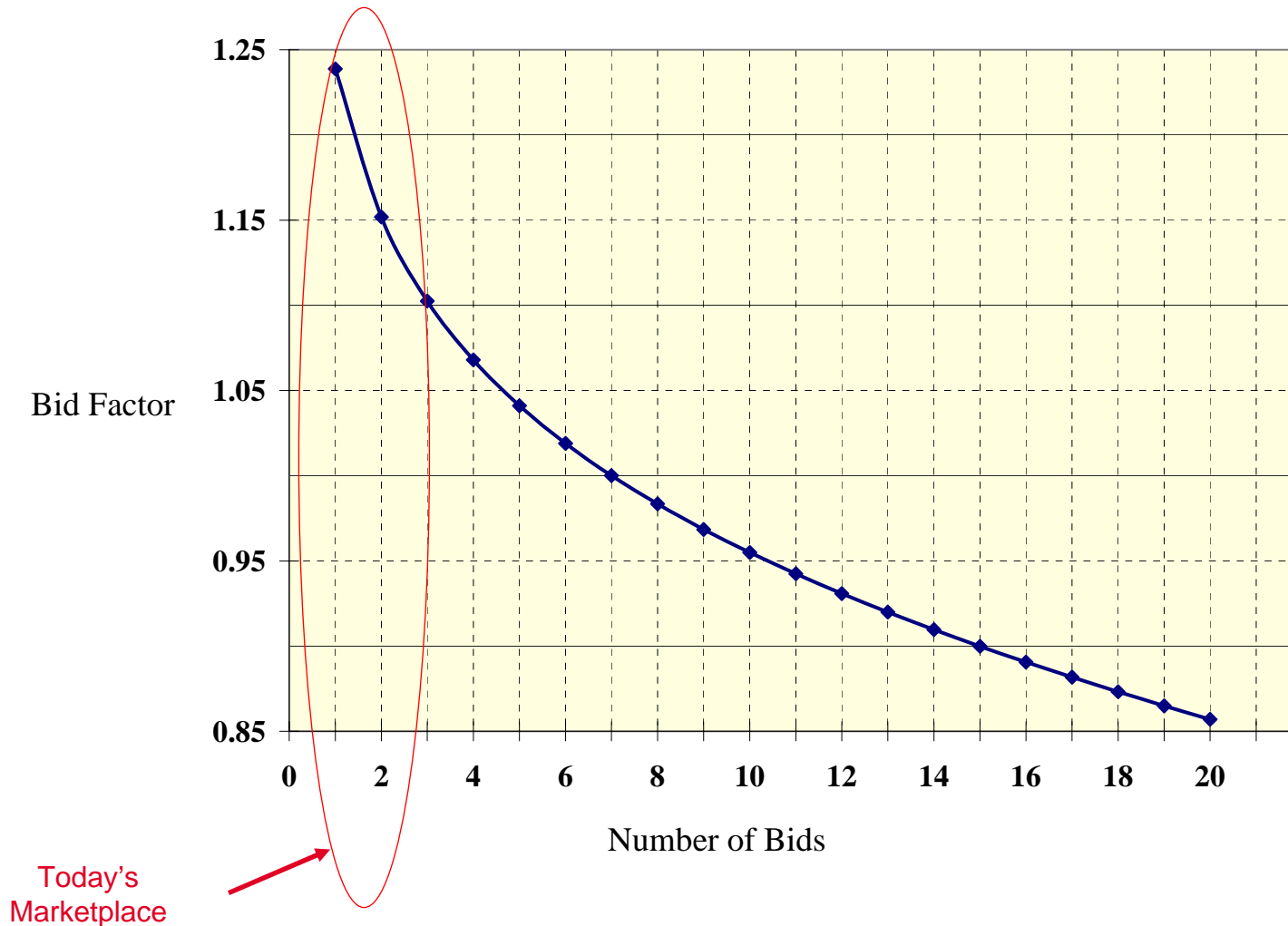
- Construction volume has been up over 10% per year since 2003
- Overseas demand has increased
- Interest rates have been low – they are going up but will still remain low
- Supply has not kept up
- Long term trends compound challenge

***Demand for construction has outstripped Supply***

# Why Prices Increase

- General inflation in materials and labor
  - Materials make up 50-65% of cost, going up dramatically
  - Labor, especially skilled labor, in short supply
- Lack of competition
  - Primes
  - Subs
  - Suppliers
- Conservative, low risk approach to bidding
  - Mark ups
  - General conditions
- Bonding challenges
- Backlogs are substantial
- Demand for construction is extremely strong
  - Bond programs (schools, universities, healthcare)
  - Infrastructure (airports, roads, utilities, etc.)
  - Private sector return on investment remains very strong
  - *More may be coming.....*

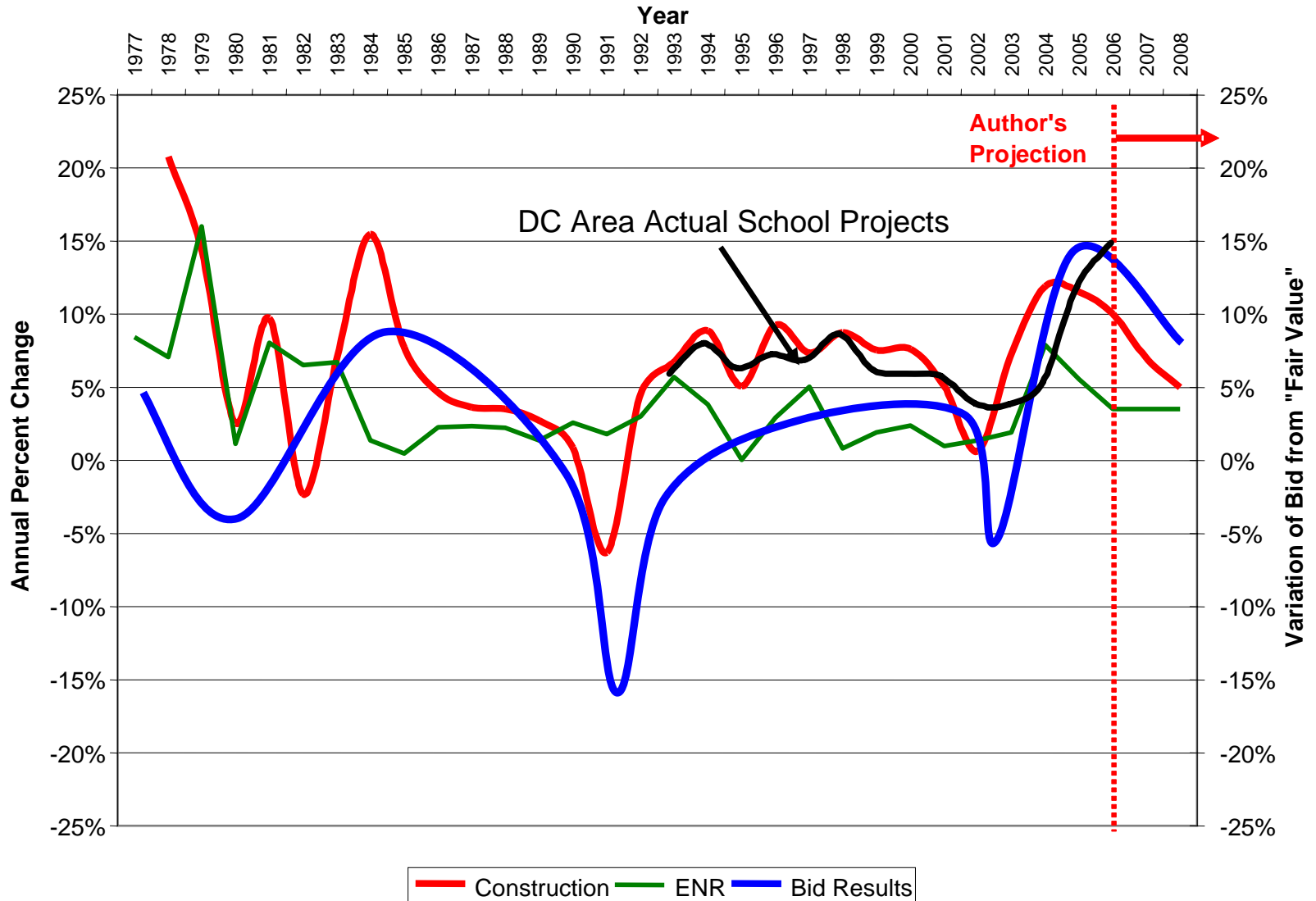
# Effect of Competition on Prices



Source: Area Cost Factor Study, U.S. Army Corps of Engineers

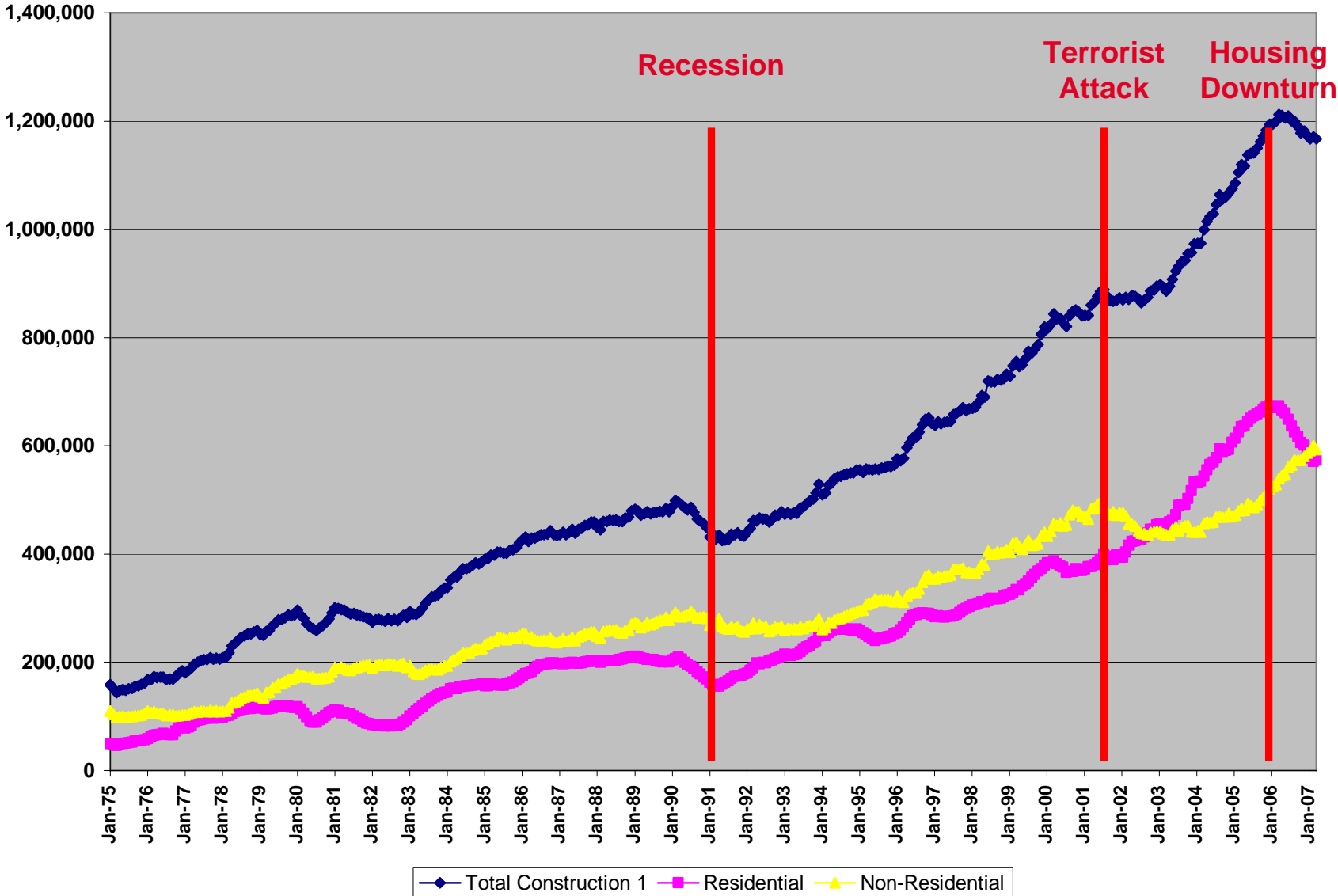
# Market Conditions

## Relationship between Volume of Construction and Bid Results



# Construction Spending

January 1975 to March 2007



# Regional Variations

- Nearly all regional markets are tight
- A few areas are still competitive
  - Where local economy is relatively slow
  - Where bond programs are modest
  - Where private investment is lagging
- Extremely challenging areas
  - West, especially Southern California and Las Vegas area
  - Southeast – especially Florida and Gulf Coast Region
  - Mid-Atlantic

# Private Nonresidential Construction

## Annual Value of Private Nonresidential Construction Put in Place by Geographic Division For Selected Types of Construction: 1993 to 2005

(Millions of dollars. Details may not add to totals due to rounding.)

	All Regions	Northeast			Midwest			South				West		
		Total	New England	Middle Atlantic	Total	East North Central	West North Central	Total	South Atlantic	East South Central	West South Central	Total	Mountain	Pacific
<b>Total nonresidential *</b>														
1993.....	113,593	20,753	7,110	13,643	27,461	20,149	7,312	38,097	19,218	6,483	12,396	27,282	7,958	19,324
1994.....	125,908	22,558	6,798	15,760	32,293	23,252	9,041	40,909	19,614	7,381	13,914	30,148	10,551	19,597
1995.....	143,908	23,083	6,207	16,877	35,701	24,471	11,229	46,684	22,980	7,992	15,712	38,439	14,727	23,713
1996.....	161,888	24,942	8,376	16,566	36,882	24,879	12,003	55,145	28,749	10,586	15,810	44,919	17,226	27,693
1997.....	179,985	29,580	9,781	19,799	40,860	30,459	10,401	64,022	34,833	11,009	18,180	45,522	16,297	29,225
1998.....	197,493	32,897	10,061	22,836	43,320	32,232	11,088	71,625	37,288	11,331	23,006	49,650	19,808	29,842
1999.....	204,053	32,298	9,733	22,565	43,732	31,760	11,972	79,068	41,881	12,738	24,450	48,955	18,328	30,628
2000.....	222,890	36,154	12,521	23,633	46,759	32,790	13,968	83,347	45,365	12,783	25,200	56,630	20,764	35,866
2001.....	218,372	38,335	13,319	25,016	46,495	32,492	14,003	79,205	42,915	12,074	24,216	54,337	19,295	35,042
2002.....	182,164	33,001	10,806	22,195	39,430	25,827	13,604	67,030	36,695	9,200	21,135	42,703	14,977	27,725
2003 <sup>f</sup> .....	176,410	29,631	10,121	19,510	38,398	25,837	12,561	69,815	36,420	11,238	22,156	38,566	13,943	24,623
2004 <sup>f</sup> .....	191,177	31,734	10,414	21,320	43,685	29,078	14,606	71,350	38,664	10,868	21,818	44,408	18,615	25,793
2005.....	208,463	32,847	10,528	22,318	48,698	32,185	16,513	76,923	41,510	12,100	23,313	49,995	21,555	28,440
Relative standa	1.1	2.5	3.8	3.4	2.0	2.6	3.8	2.1	3.2	4.8	3.7	2.7	3.5	4.2

# Bidding History and Projections

Year	Base Budget Price	Escalation	Market Premium	Bid Price Range Low to Extreme			
<b>2000</b>	\$150	2.4%	0%	<b>\$154</b>	<b>\$154</b>	<b>\$154</b>	<b>Actual</b>
<b>2001</b>	\$154	1.0%	0%	<b>\$155</b>	<b>\$155</b>	<b>\$155</b>	
<b>2002</b>	\$155	1.4%	0%	<b>\$157</b>	<b>\$157</b>	<b>\$157</b>	
<b>2003</b>	\$157	1.9%	7%	<b>\$160</b>	<b>\$172</b>	<b>\$172</b>	
<b>2004</b>	\$160	7.9%	12%	<b>\$173</b>	<b>\$194</b>	<b>\$207</b>	
<b>2005</b>	\$173	5.5%	15%	<b>\$183</b>	<b>\$210</b>	<b>\$252</b>	
<b>2006</b>	\$183	10.0%	15%	<b>\$201</b>	<b>\$231</b>	<b>\$318</b>	
<b>2007</b>	\$201	10.0%	15%	<b>\$221</b>	<b>\$254</b>	<b>\$402</b>	<b>Author's Projection</b>
<b>2008</b>	\$221	8.0%	12%	<b>\$239</b>	<b>\$267</b>	<b>\$487</b>	
<b>2009</b>	\$239	6.0%	10%	<b>\$253</b>	<b>\$278</b>	<b>\$568</b>	
<b>2010</b>	\$253	6.0%	5%	<b>\$268</b>	<b>\$281</b>	<b>\$632</b>	
<b>2011</b>	\$268	6.0%	5%	<b>\$284</b>	<b>\$298</b>	<b>\$703</b>	

# Current Conditions - Contradictions

- Overall, construction is leveling, so will the market moderate?
  - Housing construction is down – over 15%
  - But, non-housing is up – over 15%
- Markets do not overlap a great deal
  - Labor, contractors, subcontractors tend to be separate
  - Materials do overlap
- Predictions
  - Competition in commercial, industrial, institutional and public will remain tight and prices will not retreat
  - Housing downturn may affect pricing in hospitality market and may moderate educational (K-12) market

# Risk Issues

- Contract Issues
- How will the marketplace affect individual project
- How to explain the market?
- How to promote competition
- What can be done if projects bid over budget

# Contract Issues

- “11<sup>th</sup> hour advice” is unacceptable and provides no leeway to client
- Carrying an “excessive” contingency may not be feasible under client’s limitations
- Identifying a separate “bidding” contingency may be sellable
- Redesign? - Regardless of whether a redesign clause exists, owners/clients expect their designers/consultants/contractors to know the marketplace and control the cost – and may still expect a no cost redesign

# How will the market affect individual projects?

- Under construction
  - Cost already factored in
  - Changes, especially delay claims will be aggressively pursued
- Under design
  - Bidding within a year – expect a significant premium – 10-20%
  - Beyond a year – carry at least 10% bidding contingency
- Alternate delivery systems
  - Design-Build – early pricing may be very conservative
  - CM & GMP – may be conservative or may defer “bad news” until buyout

# How to Explain the Market?

- Be aggressive with subject of market
  - Escalation
  - Market factors
  - Conservative markups
- Owners should be aware of the market but that doesn't mean they will listen
- Involve owner in all decision making
- *Take particular care with design and material choices that are or could be considered "expensive"*

# How to promote competition

- First - Remember – subcontractors are dominating the current market
- Second – consider some creative approaches
  - Bid in current dollars and use escalation clauses
  - Bid allowances for future work and negotiate when work is needed
  - Separate work into packages
    - Core and shell
    - Wings, Buildings areas, Etc.
  - Allow optional delivery times – shorter may be better
  - Time and material for sensitive tasks
  - Take care with limited availability materials
  - Take care with other contract requirements

# What can be done if projects bid over budget?

- Hopefully, owner was advised of possibility before bid
- Examine bids in as much detail as possible
  - Number of primes is significant
  - But – number of subs per trade may be more significant
  - Talk with second bidder if rules allow
- If re-bidding
  - Review owner General Requirements carefully
  - Allow reasonable time for re-bidding
  - Be careful with complicated bid forms
  - Monitor other projects that are bidding to avoid conflicts
  - Examine specifications and details that can be easily modified
  - Negotiation (if allowed) may be superior to re-bidding
  - Adding more time to market may not improve price