

MEMO 4/21/2019

K-12 MARKET CONDITIONS & MANAGEMENT CONSIDERATIONS

PRESENTED TO THE SKSD COMMUNITY BOND OVERSIGHT COMMITTEE

News has been made recently about [unprecedented inflation in the local construction market](#) (OSBA: "Unexpectedly steep increases in construction expenses strain bond plans" 7/9/18) and peer districts that have been [caught unprepared](#) (OregonLive: "Portland school construction could top \$1 billion.." 4/16/19) for the strain these cost increases pose to their capital bond work.

It is our imperative to ensure that Salem-Keizer School District is well-equipped to deliver their voter-authorized Bond Program to the fullest capacity possible. With the benefit of lessons learned and best practices conducted at peer districts who have successfully weathered the market, we present the following analysis to the SKSD CBOC of:

- Market Conditions & Escalation
- Budgeting Best Practices & Establishing Contingencies
- Establishing SKSD as the Ideal Client

Armed with these considerations and strategies, the SKSD CBOC will be positioned help guide conversations on the decisions ahead and oversee bond management practices with financial context in concert with the educational, community, and safety priorities of this Bond.

MARKET CONDITIONS & ESCALATION

Project Escalation is a budget factor applied to projects to cover variable construction market conditions as material / labor prices are impacted by supply and demand. It is typically budgeted to the *start* of a hard-bid project or to the *mid-point* of a CM/GC project.

Rider Levitt Bucknall, industry-leading cost estimators, have observed the Portland Metro market currently at a **7.13%** escalation rate with K-12 costs are currently estimated between \$290-360 /SF for Elementary and \$305-365 /SF for High Schools ([RLB 2019 Q1 Report](#)). This is up from 6.05% observed in their 2018 Q1 Report and 5.76% in their 2017 Q1 Report. Actual Construction Costs are being observed as higher, particularly when factoring in site costs.

This figure is substantiated by data from peer districts and in ongoing conversations with the local General Contractor and Architectural / Engineering (A/E) community.

- Peer districts have observed poor competition in General Contractor Solicitations for Hard Bid & CM/GC Services with as low as 1-2 responses
 - General Contractors have cited the subcontractor market and available trade labor as a primary limitation
 - Other major projects are pending for major local corporations including Nike and Intel, which typically have the budgets to offer incentives for trade labor commitment
 - Rural markets have been most impacted due to cost of travel and lost work-efficiency due to commutes
 - Stringent MWESB requirements can lower pool of available, qualified subcontractors
- One peer district received no responses to a summer paving solicitation and a "full overtime" bid on an abatement project (where the contractor did not have capacity in their typical work schedule, but volunteered to complete during extended hours)
- Up to 20 - 30% cost increases has been observed on quotes / bids beyond initial estimates

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- Construction schedule requirements to meet school year start/end times are also cited as a constraining factor on the industry-limited pool of experienced General Contractors during universally popular summer windows of work (which must be seized for regionwide for roof/dry-in work)
- Multiple bond passage in Portland Metro & SW Washington Area has also stretched K-12 experienced A/E consultant pool, increasing "soft" costs and extending design schedules
- Tariffs have augmented costs on steel and lumber, which is in demand as an alternate; trucking costs have been impacted by material availability and nationwide costs

Management Strategies & Success Stories

- Utilizing CM/GC delivery on projects has been successful as means of staggering bid packages to be more strategically timed with subcontractor availability and Contractors have preferred using this delivery as an approach to capture potential risks within "allowances"
 - A recent Middle School project GMP was initially reconciled at \$50.7 M in December 2018 but has since been revised *down* to \$46M after highly-competitive bid response received by targeting the market early. At buy-out, this puts the project nearly in line with it's original \$45.3 M budget.
- With escalation increasing steadily, some districts have chosen to pursue aggressively frontloaded design schedules to initiate construction at multiple sites earlier than anticipated in advance of mounting years of escalation.
- In balance with design schedule considerations, Teams have observed noticeable benefits and reduced Change Orders by allow consultants ample time to produce well-coordinated and "efficient" documents
- Pursuing readily available and local materials has limited project exposure to tariffs and trucking costs.

BUDGETING BEST PRACTICES & ESTABLISHING CONTINGENCIES

While it may be impossible to predict the future, it is the prerogative of the Project Team to "foresee the unforeseeable" with astute budgeting practices and by establishing appropriate contingencies at the outset of a bond program.

Project Managers are responsible for overseeing the budgets and adjusting for the appropriate level of risk, which is highest early in design and construction, when the least amount of information is known, and lessened as buildings come out of the ground and various trades phase off the site.

To manage this, budgets are developed with several potential types of contingencies in addition to the *escalation* factor carried:

- **Construction Contingency** – Held for Construction "Hard" Costs and utilized to navigate unforeseen conditions encountered in the field (ex. Poor soils). Risk is typically highest in early construction during demolition / excavation
- **Design & Estimating Contingency** – Held for Construction "Hard" Costs and utilized as a scaling factor of certainty during design to account for potential estimating "misses" due to incomplete drawings; lowered as project develops
- **Owner and/or Project Contingency** – Applied to Owner & Consultant "Soft Costs and utilized for permitting/jurisdictional cost overruns, unforeseen needs for specialty consultants or incurred legal costs
- **Program Contingency** – Project cost overruns that cannot be managed within budget, typically seen for substantial unforeseen jurisdictional costs, construction costs exceeding escalation and where the Bond budget did not appropriately budget for the necessary scope

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Management Strategies & Success Stories

- One District initiated their bond without a budgeted Program Contingency and only a 5% escalation factor built into their program. They fortunately realized a substantial premium on initial Bond Sale and fully utilized proceeds to fund a Program Contingency, rather than target for additional project work. This Contingency has been an invaluable resource to reconcile construction budgets and fully deliver on the voter-promised scopes of work.
- Construction Contingencies should be adjusted by project type. Three to Five percent (3-5%) is typical for new construction / "greenfield" development with minimal risk and no less than 8% is recommended for major remodels.

ESTABLISHING SKSD AS THE IDEAL CLIENT

In a market that favors suppliers vs. consumers, it is important for us to position SKSD as the most attractive partner possible to solicit maximum competition and quality industry performers. Much of this can be accomplished with good attention to detail and organization such as:

- Being realistic about market conditions and budgeting accordingly by anticipating the high-end of the cost / SF range versus the low
- Conducting regular due diligence on local labor availability, non-local options and peer district costs to adjust budgets and schedule expectations
- Streamlining construction processes, design/RFI reviews and on-time payments
- Providing clear, complete and robust documents and making/holding to design decisions (changes during construction are costly and can impact quality and contractor relations)
- Pursuing relationships with local jurisdictional agencies to confirm development requirements / costs early, simplify reviews and facilitate fee payments

Considerations can also be made in the design process to optimize flexibility:

- Agreeing to pursue "conservative" designs from the outset such as readily-available "off-the-shelf" vs. custom design options to increase Contractor competition by limiting the number of specialty trades required, reduce long-lead times and increase G/C's efficiency at completing projects (lucrative so they can move onto other work)
- Employing project alternates wisely: alternates can be potentially cost/time-consuming to manage if used as a strategy to pursue potential scope "extras," however, the District's willingness to including *established* scope items at alternates that can be postponed to a later date or pursued through alternate means can lessen upfront costs and defer risk of overspending early in the bond

While the construction schedules of School Districts are typically exacting to account for the start / end of the school year, some considerations may be made to optimize flexibility and meet G/Cs in partnership of the shared goal to complete projects on schedule and budget:

- Some Districts have opted for flexible schedules and mid-year turnovers/moves to allow modest school projects to avoid busy Summer windows when feasible
- Working with school administrators and pursuing security clearance requirements to allow certain, minimally-to-less disruptive work to occur during school hours
- Snow / make-up days and school calendaring for the following year should factor in contractual construction schedule; early dismissal may be considered for schools with limited summer construction windows and "hold harmless" agreements may be made for bond schools to not add back days that might detract from schedule

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SUMMARY STATEMENT:

Based on the collected and analyzed market information presented we believe SKSD is well positioned to fulfil the obligations set forth in the bond resolution. The SKSD program was developed for success with adequate budgets and contingencies. SKSD senior leadership is experienced in the delivery of large capital construction programs and has procured experienced project management oversight. We believe the program is on track to more than meet its promises to the community.

DAY will continue to monitor the industry and work with SKSD bond program leadership to adjust the program in response to future market conditions.