

Construction Law: Don't Promise What You Can't Deliver

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PRESENTATION OVERVIEW

Pricing Projects in an Uncertain Marketplace

- ◆ Today's reality
- ◆ Case study example
- ◆ Preparing better budgets



Factors Driving Price Increases

- ◆ Construction volume up 10%+ annually since 2003
- ◆ Overseas demand increased (China, India, Middle East)
- ◆ Interest rates going up, but still low
- ◆ Basic supply and demand – supply can't keep up
- ◆ Long-term trends compound challenge
- ◆ Limited bidders (primes, subs, suppliers)
- ◆ Numerous delivery methods
- ◆ More negotiation

Factors Affecting Bidding

- ◆ Risk premium
- ◆ Purchasing aggressiveness
- ◆ Indirect costs
- ◆ Technological/information advantages
- ◆ Opportunity cost
- ◆ Profit

***Each category can affect 5-10%
Combined more than 30%***



Current Conditions

- ◆ Competition in commercial, industrial 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



Regional Variations

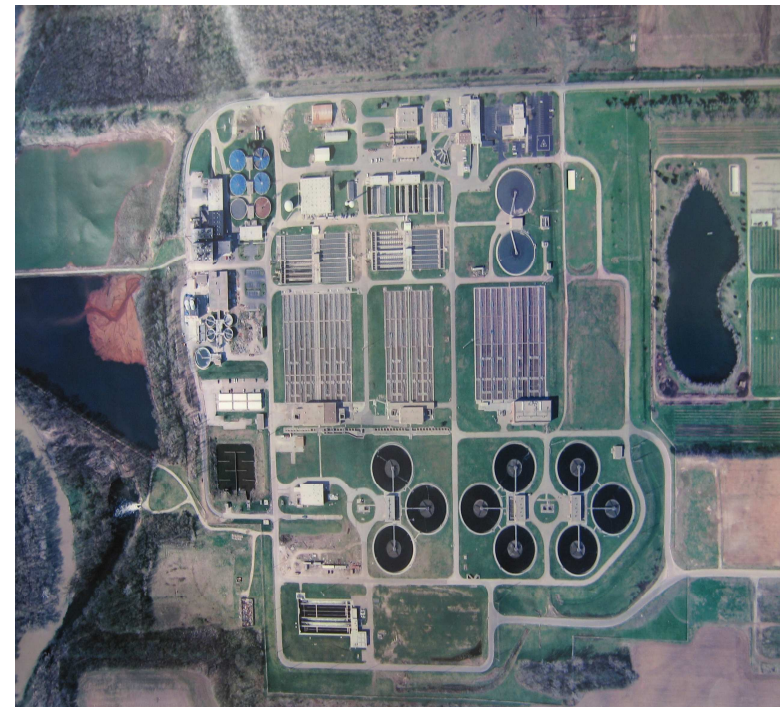
- ◆ Nearly all regional markets tight
- ◆ Follows GDP
- ◆ Few areas competitive:
 - Local economy relatively slow
 - Bond programs are modest
 - Private investment lagging
- ◆ Extremely challenged areas include the West (Southern CA, Las Vegas, Salt Lake City, South Florida)
- ◆ Moderate: DC, Boston, Chicago, Denver
- ◆ Modest: Detroit, Cleveland, Memphis

What does all this mean?

- ◆ 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%
- ◆ Alternate delivery systems
 - Design-Build: early pricing may be very conservative
 - CM & GMP – may be conservative or may defer “bad news” until buyout

Case Study: Columbus, Ohio

- ◆ Columbus, Ohio wet weather management plan
- ◆ City committed to \$186 million of improvements that will now cost \$292 million
 - 73% original scope (\$213 million)
 - 27% additional work identified (essential improvements) (\$79 million)



Case Study: Columbus, Ohio

Current instructions to Design Professionals:

- ◆ 8% Material escalation factor compounded annually through midpoint of construction
- ◆ 10% General conditions
- ◆ 1% Mobilization
- ◆ 5% Bonds, Permits & Insurance
- ◆ 15% Contractor Overhead & Profit
- ◆ 10% City Contingency
- ◆ Design Contingency that varies. At final design, it goes to 0% (40%-0%)

Case Study: Columbus, Ohio

- ◆ Three projects bid but not awarded yet totaling \$120 million
- ◆ Award not likely to happen until Feb. 1 due to financial/political issues
- ◆ Cost of this delay estimated to be \$3 million



Lessons Learned: Prepare Better Budgets

◆ Educate & Involve Management

- Unlikely any project in next two years will bid within its budget unless substantial market contingencies included
- If budget not adjusted, you'll have to reduce scope, quality or add delays and funds
- Involve management in all decision-making

◆ Clarify

- Escalating cost of labor and materials
- Competition is the driver
- Design and material choices considered "expensive"

◆ Execute

- Add separate bidding contingency tied to anticipated bidding

Lessons Learned: Promote Competition

- ◆ Subcontractors are dominating the current market
 - Enhance competition with contracts, provisions, bonding & insurance requirements, schedule, etc.
- ◆ Advertise intelligently
- ◆ Funding is certain
- ◆ Payment is prompt
- ◆ Design & specify wisely
 - Avoid scarce materials, complex systems & exceptional workmanship
 - Avoid proprietary choices
 - Good quality documents



Lessons Learned: Over Budget?

- ◆ Advise management before bid
- ◆ Examine bids in detail
 - Number of primes significant
 - Talk with second bidder if rules allow
 - Negotiate if allowed instead of re-bidding
- ◆ If re-bidding
 - Review management General Requirements
 - Allow reasonable time for re-bidding
 - Be careful with complicated bid forms
 - Monitor other projects that are bidding to avoid conflicts
 - Examine specs/details that can be easily modified
 - Adding more time may not improve price



Final Thoughts

- ◆ An intelligent approach to pricing is essential
- ◆ Volatility and change are happening – must plan for change
- ◆ Discuss these issues with your engineering staff

