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How to survive the great public bid crisis

- *Bidding projects during the winter will avoid a lot of bid escalation.*

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The recent public construction bid climate has everybody paying a lot more than expected for their projects. This has caused some projects to be shelved, reduced in scope or completely abandoned.

Labor rates are up, material prices continue to increase, and shortages in both can kill a project. Bidders seem to be a lot pickier on what they will bid.

What happened? What is happening now? What can we do to protect our project's budget? Read on to learn how to survive the greatest bid crisis this decade has ever seen.

What happened?

We are in the midst of a construction boom all over the country.

Locally, this has caused a labor shortage that affects costs twofold: sub-bids are coming in higher to make the job worth it; and contractors are working overtime to finish the job, causing labor to be paid at overtime rates.

During the last three quarters (November 2006 through May 2007), the DJC's published bid results showed that out of 32 public bids, 60 percent were rejected because the bids came in too high. The projects' budgets ranged from \$50,000 in electrical upgrades to a \$46.7 million high school. The actual bids came in from \$130,000 to \$60.5 million — a range of 10 percent to 150 percent over budget!

Out of these 32 sample projects, there was only one that came in on the estimated budget. While 18 of the projects were rejected, many municipalities just bit the bullet and went for the higher costs.

The average number of bidders per project during the period was 1.5 and the average project was overbid by 25 percent. Ouch!

What is happening?

Yes, things are getting better. Because the residential bid climate is cooling and contractors have caught up with their hiring needs, the labor shortage is less of an issue. Also, some material prices are even dropping.

According to Engineering News Record: "Construction inflation is no longer firing on all cylinders, thanks to an ever-deepening recession in residential construction markets and a cooling off in global commodity markets. Materials prices with a high-end use in housing are in a free fall, with the most dramatic decline this year coming for gypsum wallboard. And economists predict rollbacks in cement prices soon."

Between September and October, the DJC's published bid results showed that out of 27 public bids only one was rejected because the bids came in too high. Out of those sample projects, there were six that came in on the estimated budget and the average number of bidders rose to 2.5 while the average bid spread was 20 percent. Actual low bids averaged 10 percent over budget.

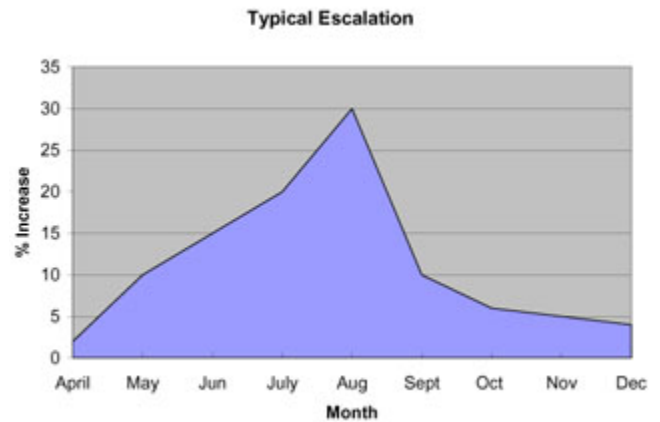


Image courtesy of Matson Carlson & Associates

Bids prices tend to escalate in the summer months.

Protect your projects

We interviewed 12 Seattle- and Spokane-area large general contractors and asked them about the bid environment and what owners can do to save their projects. They all said the same thing:

1. Public projects are no longer attractive to the general when there are many private projects bidding that have fewer strings attached (risks that can cost money) and are more lucrative. If the front-end documents of more public projects were simplified, they would be more attractive to bidders.
2. Many of the generals are booked with work through 2008 and beyond. Some will no longer bid ANY public projects, while some said they would consider it if the project was attractive and fit their schedule.
3. The number one thing that they all suggested was the time of year to bid: October through March. Anytime else and you can throw the budgets out the window. You will get fewer bidders — if you're lucky enough to get even one — and the generals will get fewer sub-bids, causing them to throw in a last-minute "safe" allowance. Also, material costs escalate during the busy time of the year.
4. Make as much of the project design-build as you can.

We strongly agree with No. 3. As construction cost consultants, we see projects with bid dates that are determined by their design schedule or by the owner's occupancy schedule — with no account taken for the bid climate in the summer months. The bid climate changes and sets the rate of escalation on a look-back basis.

Escalation

Look up bid escalation in a publication: 7.5 percent per year. Look it up on the state of Washington's OFM Web site: 3.3 percent per year. Sellen Construction said 9 percent per year in 2006 and Absher Construction said 10 percent (6 percent for 2007).

So what is escalation and how is it measured? Escalation for the construction industry looks at the cost of construction from January one year to January the next year and compares the two. This number will vary from contractor to contractor and agency to agency.

So how can there be only 6 percent escalation in 2007 when the actual bids average 10 percent over budget? The answer is because escalation spikes during the busy summer months. If escalation were measured from January to July, it would show 25 percent to 50 percent or more in some cases. Escalation as a rule does not take this spike into account and it can cost a project its life!

We advise all of our clients to NOT bid during these busy months. If you have a project scheduled for May through August, you will actually save money by waiting to bid until November or, even better, February.

What else?

The current escalation rate is 6 percent. You should be using this rate on your project's budgets. If your agency does not allow this rate, simply add a line for a bidding contingency. If the bid date is in the summer months, you will need to add a summer bidding contingency of 10 percent to 25 percent, depending on the local volatility of the bid climate.