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2017 Annual Infrastructure Construction Cost Inflation Estimate

October 17, 2016

Annual Infrastructure Construction Cost Inflation Estimate (AICCIE)

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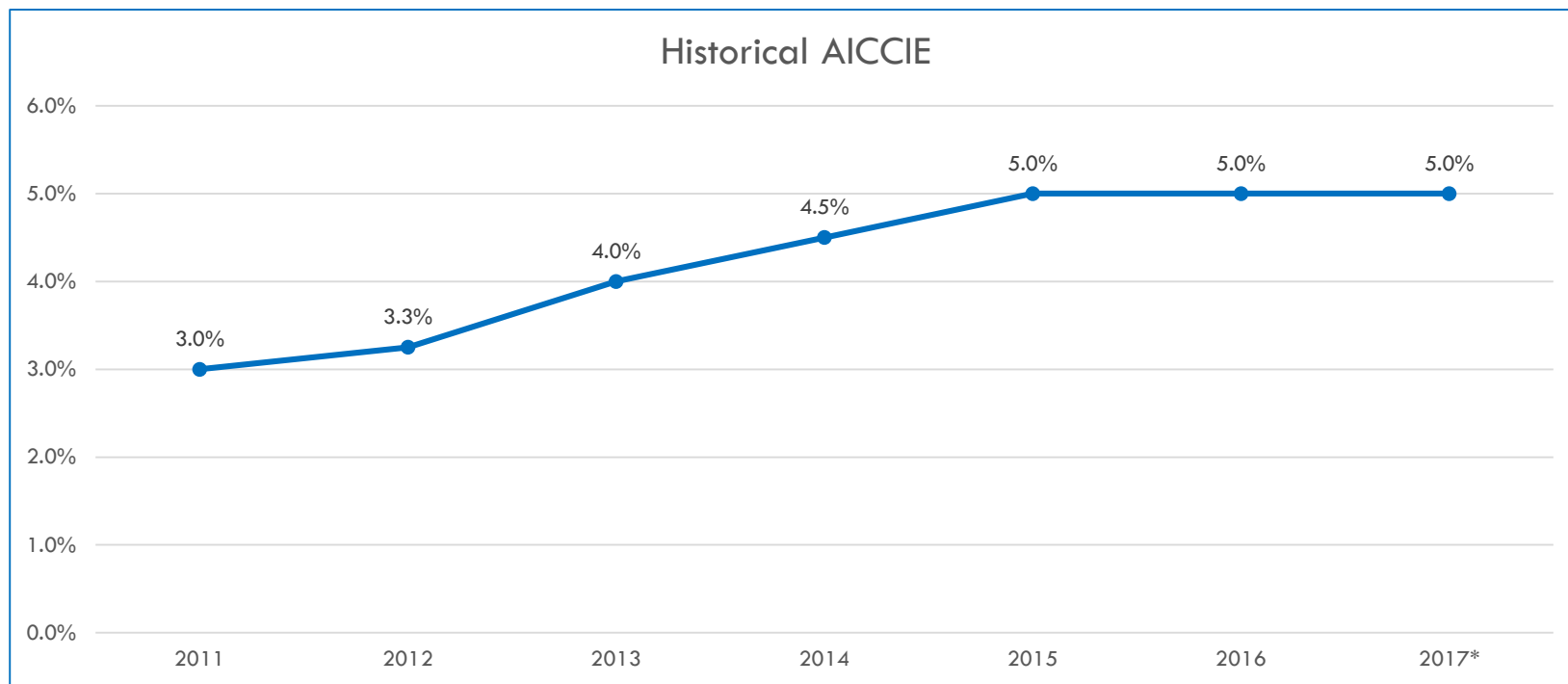
- Today's Action item: Adopt the AICCIE for CY 2017

- AICCIE: projected rate of construction cost escalation for the upcoming calendar year, used to:
 - Forecast costs for the 2-Year Capital Budget & 10-Year Capital Plan
 - Annually adjust developer impact fees
 - Update FRRM and other city forecasting tools

AICCIE Recommendation CY2017

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- CPP recommends an AICCIE of **5%** for CY 2016
- Construction still booming even as slowdown looms



*pending CPC acceptance

Local Market Reality

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The health of the local economy is driving record amounts of construction, resulting in **more work than the plant can easily perform and escalation in excess of labor and material cost increases**

Escalation Indices

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Construction Index	Description	2010	2011	2012	2013	2014	2015	2016
Turner Building Cost Index	Change in costs of non-residential building construction nationwide	-4.0%	1.6%	2.1%	4.1%	4.4%	4.5%	4.8%
BLS New Construction PPI	Change in output price of new non-residential construction	-0.1%	2.8%	2.9%	1.9%	3.1%	1.7%	0.6%
BLS Maintenance Contractor PPI	Change in costs of price for work done to maintain and repair non-residential buildings	0.4%	2.2%	1.9%	1.7%	2.8%	2.0%	1.4%
BLS SF Metro CPI	Change in cost of local cost of consumer goods	1.0%	2.9%	2.8%	2.0%	3.0%	2.6%	3.1%
BLS SF Metro Employment Cost Index	Change in employment cost (averages Total Compensation and Wages/Salaries)	-	-	-	-	4.5%	2.2%	2.2%
ENR CCI – San Francisco	Change in SF <i>common</i> labor and materials	1.9%	2.8%	1.7%	5.3%	4.9%	2.4%	3.6%
ENR BCI – San Francisco	Change in SF <i>skilled</i> labor and materials	2.5%	6.0%	1.5%	3.7%	3.0%	2.6%	3.7%
TBD Consultants Bid Index	Change in construction bid cost for an indexed building project scope in SF	4.3%	14.8%	7.6%	6.4%	4.2%	12.5%	5.0%
Local Expert Average	Estimated cost escalation rate for the coming year	-	-	-	-	-	5.1%	5.1%
AICCIE	City of SF estimate for escalation in the calendar year listed (i.e. 2015 AICCIE is the estimate made in October 2014 for 2015)		3.0%	3.25%	4.0%	4.5%	5.0%	5.0%

- 2016 average across all listed indices: 3.95%
- 2016 average across all local indices (shaded rows): 4.56%

2017 SF Experts Projected Escalation

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Organization	Cost Escalation Estimates for 2017
Stanford University	3%
Cumming Construction	5%
Jacobs	6%
Leland Saylor Associates	4%
M. Lee Corporation	5.5%
Pankow	4 - 7%
TBD Construction Consultants	5%
Turner Construction	4 - 5%
Webcor	5 - 6%

Industry experts are estimating SF 2016 escalation in the range of 4-7%
Average (excluding Stanford): 5.125%

Contractor/Project Manager Perspective

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With so many projects, contractors can afford to be pickier, which can create less competition for a given project

Subcontractors in particular trying to capture higher fees

Empty labor halls and unrelenting demand translate to hiring of less productive workers, also shortage of supervisors

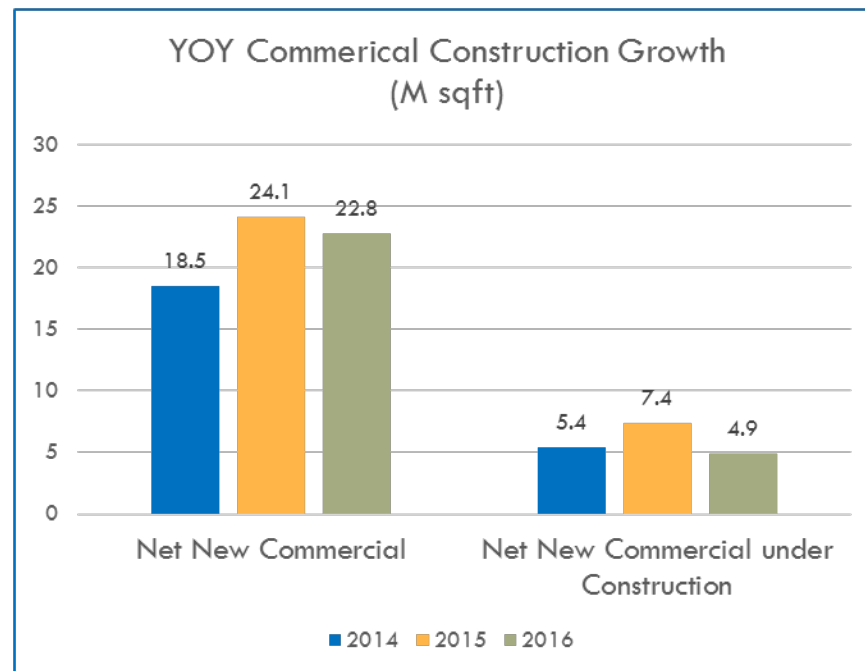
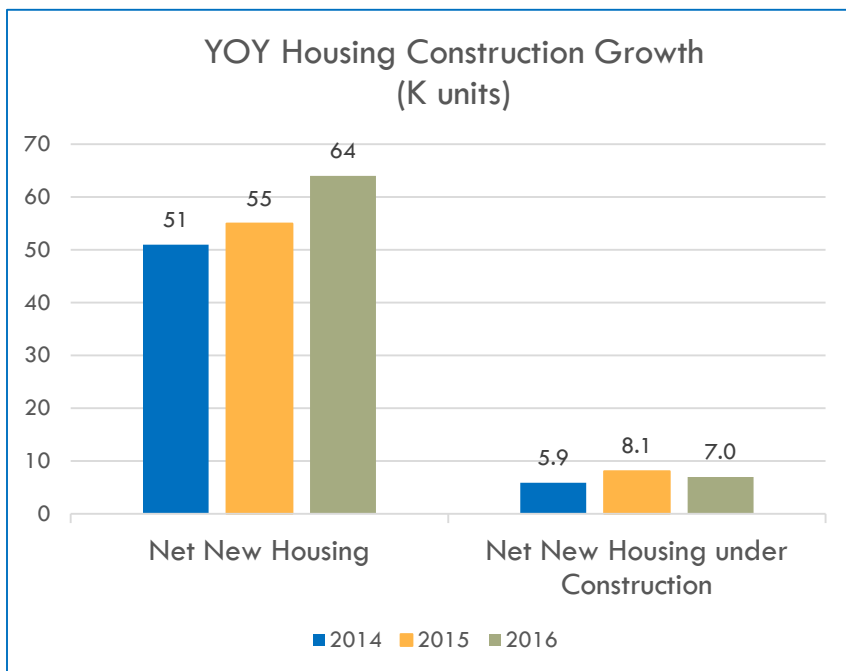
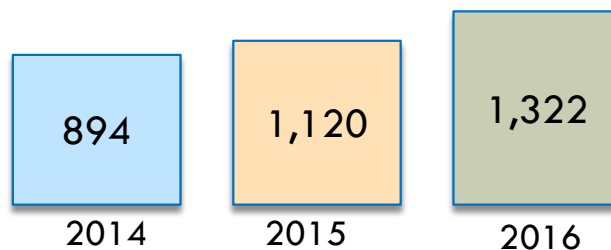
Materials costs rising but a secondary driver of project costs

Contracting with a complex client like the City/Bidding on more unusual projects becomes less desirable when there are more straightforward options

SF Planning Pipeline Statistics

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Projects in Pipeline



Local Construction Cycle Perspective

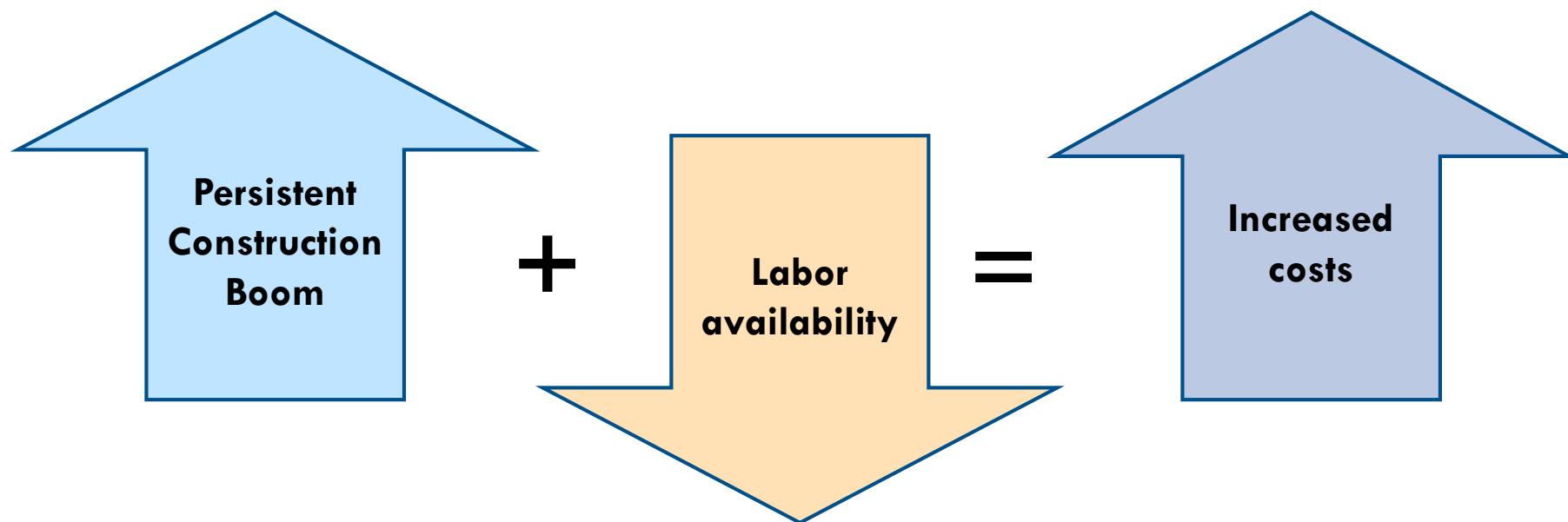
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- Some flattening in project pipeline, in line with national trend
- San Francisco still one of the top ten office construction markets nationally
- San Francisco has the third lowest office vacancy rate nationwide
- Prop M cap in play
- Continued priority on building affordable housing likely to continue



Local Labor Considerations

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- SF unemployment: 3.7%, well below national level of 5.1% (July 2016)
- SF area construction employment up 7.9% from 2015
- Shortages in specialized subcontractors and labor
- 33.7% higher construction labor hourly wage than national average

Construction vs. Labor Volume Over Time

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Impact of # of Bids on Costs

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- SF is in a higher cost multiplier band as last year, at approximately **2 average bids per construction project**.

Journal of Construction Engineering & Management (National, 2005)	
# of Bids	Low Bid Deviation From Estimate
1	1.15
2	1.11
3	1.07
4	1.01
5	0.95
6	0.91
7	0.89
8	0.88

Saylor Consulting (Bay Area, 2015)	
# of Bids	% Differential (estimate vs. bid)
1	+25% to 50%
2-3	+10% to 25%
4-5	0% to 10%
6-7	0% to -10%
8 – 10	-10% to -20%

Current SF Market

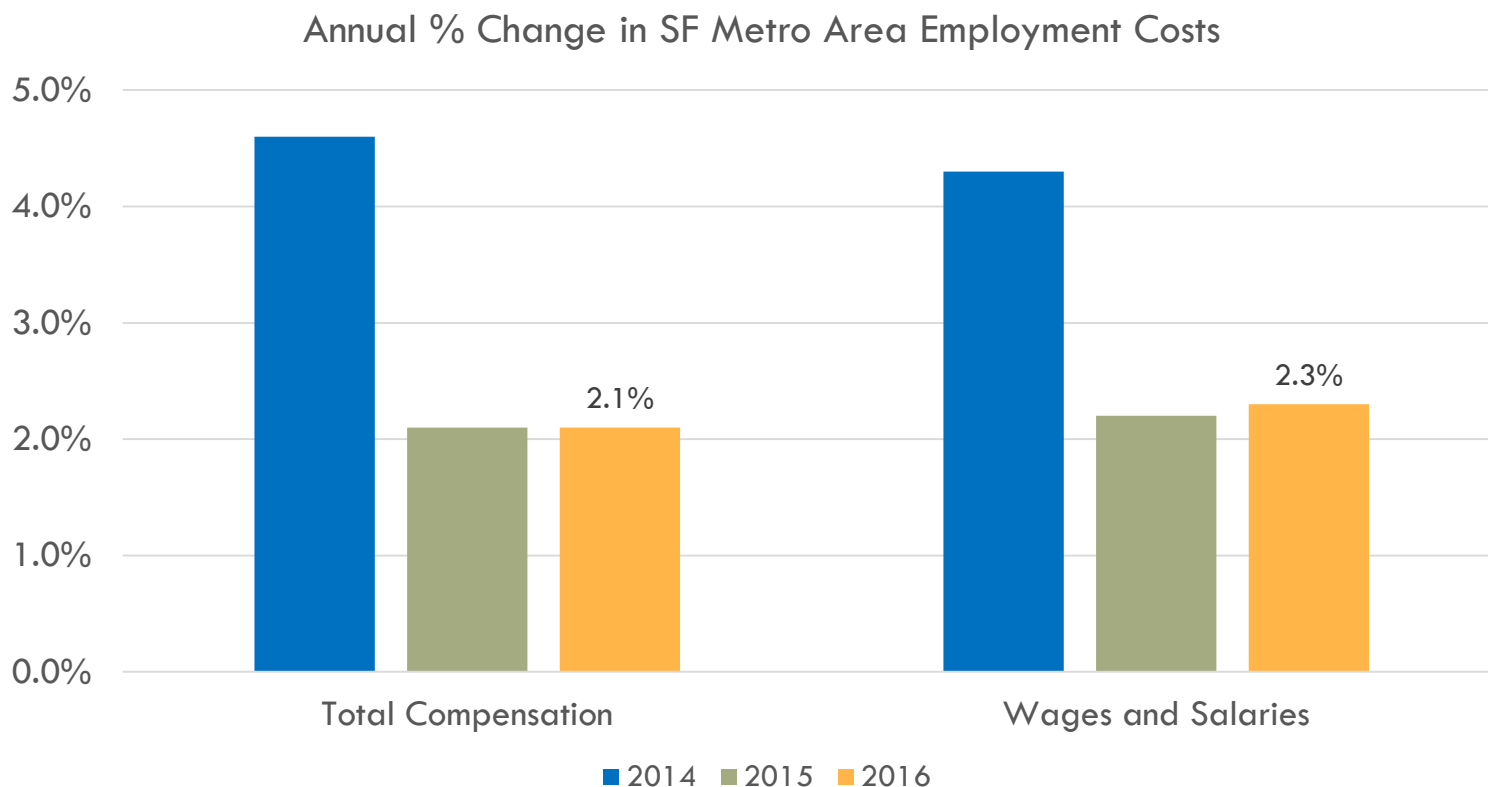
Last Year

Source: Saylor Consulting Market Trends 2015 Construction Forecast

Local Private Industry Employment Cost Index

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- Continued annual rise in cost of both total compensation and wages and salaries at similar rate to last year

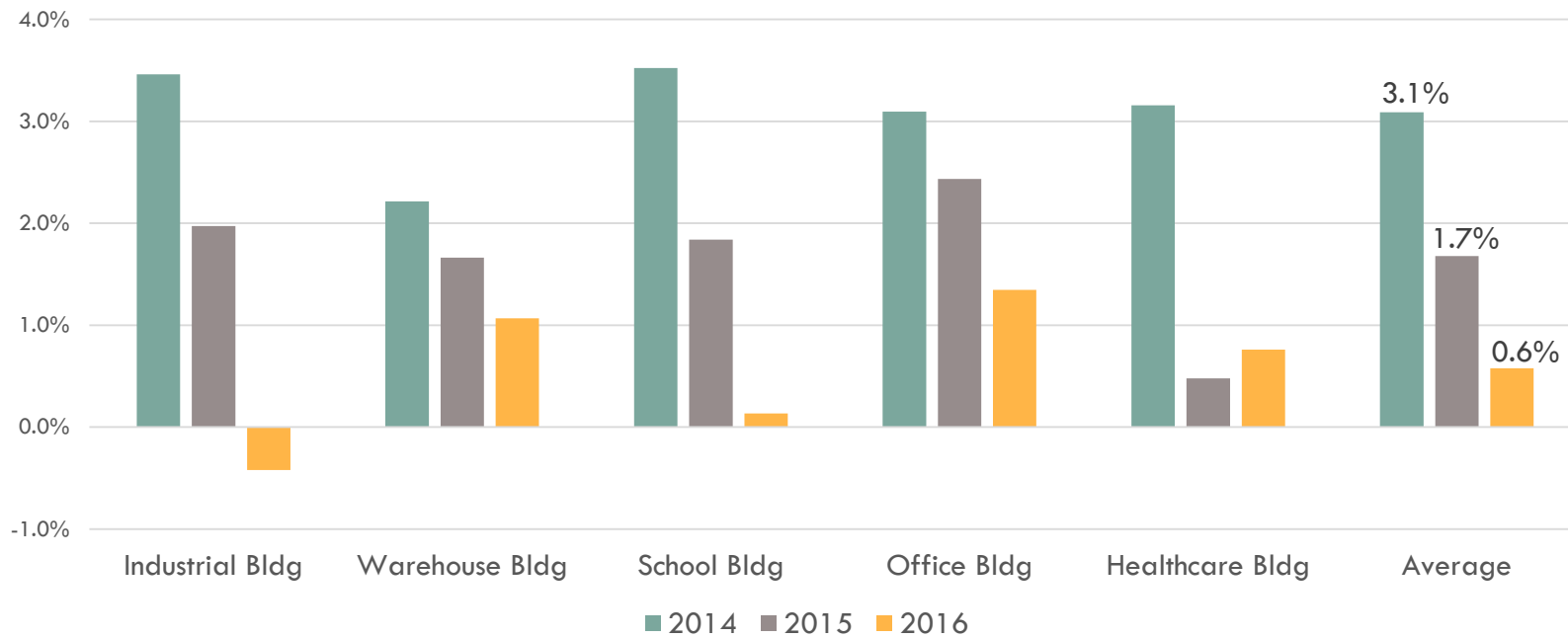


National New Construction Cost Indices

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- Continued rise in cost of new construction for most non-residential building types, but less steep than last year for most categories

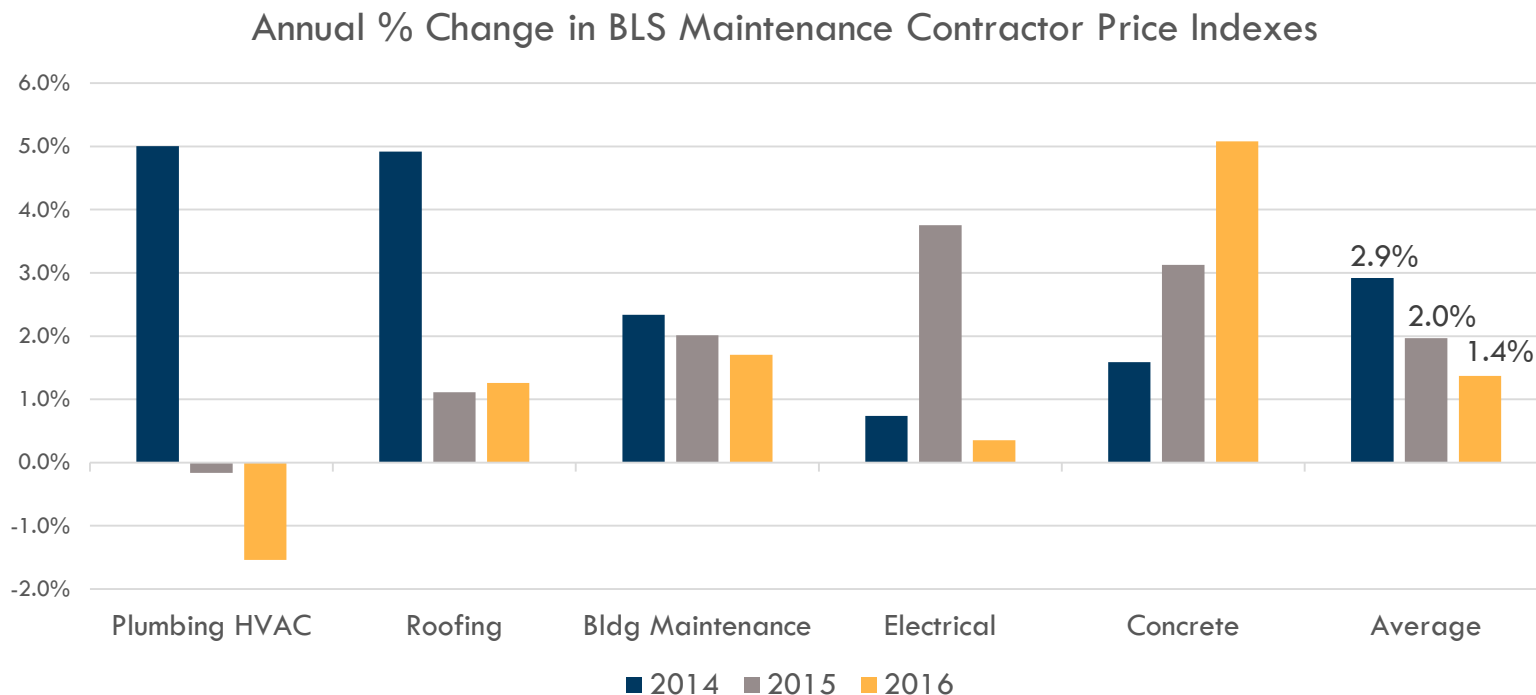
Annual % Change in BLS New Construction Cost Indexes



National Maintenance Contractor Cost Indices

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- ▣ Mixed pattern in cost change of maintenance contractors with net increase



Materials Costs – Special Concerns

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- Volatile prices in certain materials
 - Metal stud framing
 - Structural steel
 - Glass
- Significant backlog at factories and mills nationally
 - Curtain wall and elevators 12-18 months lead time

Local Sector Forecast

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SF CURRENT MAJOR PROJECTS (\$500+M)

Transbay Transit Center
 Treasure Island
 Salesforce Tower
 Parkmerced
 Third Street Light Rail
 Seawall Lot 337 Mixed Use
 HOPE SF @ Sunnydale
 Schlage Lock
 Oceanwide Center
 Executive Park
 Chase Center

- Annual construction volume forecast at 7.8% for 2016 and 7.7% for 2017, on top of double digit gains from 2012-2015
- Currently in the midst of fifth consecutive annual construction growth rate increase
- Annual construction volume forecast to hit \$34.3B in 2017, exceeding 2005 peak
- Volume surge still led by residential sector
- Expected volume **decrease** in 2018 (-1.3%) and 2019 (-0.5%)

Relevant Legislation

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- ▣ Transportation Sustainability Fee (as of Nov 2015)
- ▣ 25% Affordable Housing Requirement (as of Jun 2016)
 - ▣ CON recommending a more gradual approach
- ▣ Continued 30% Local Workforce Requirement
 - ▣ Increasing from 20% by 5% each year since 2011, frozen at 30% until March 2017
- ▣ Public Health & Safety Bond (approved June 2016)
- ▣ Schools and BART Bonds on the November ballot
- ▣ Measures O and P on the November ballot
 - ▣ O: Exempts office space in Candlestick Point and Hunter's Point from Prop M limits
 - ▣ P: Mandates at least 3 proposals for all affordable housing projects

SF Debt Program and Enterprise Fund Projects

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Enterprise Fund Projects
Central Subway
Transit Optimization Program
Pier 70
Sewer System Improvement
SFO On-Site Hotel and Terminal 3
Active GO Bond Programs
2008 and 2012 Neighborhood Parks & Open Space
2010 and 2014 ESER
2011 Road Resurfacing & Street Safety
2014 Transportation
2015 Affordable Housing
2016 Public Health & Safety
Other Major Public Building Projects
Mosccone Expansion

Conclusion

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- ▣ Strong demand continues to be major construction cost escalation driver
- ▣ Bidding environment remains favorable for contractors/subcontractors
 - ▣ Labor: high demand, tight supply
 - ▣ Subcontractor trades continue to increase profit margins
 - ▣ Materials costs overall low
 - ▣ Few bids coming in
- ▣ Local experts are using 2016 escalation rates of 4.0% to 7.0%
- ▣ CPP's recommendation of **5%** is in line with experts' predictions. It is higher than cost and material indices suggest on their own due to the strong effects of high activity, low bid counts, limited locally available labor resources, and contractor selectivity.

Questions or Comments?

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