SEATTLE PUBLIC SCHOOLS

BEX Oversight Committee
July 14, 2017, 8:30 -10:30 am
Conference Room 2750, John Stanford Center
2445 3rd Avenue South, Seattle, WA 98134

Minutes

Call to order (John Palewicz)

1. Chair John Palewicz called the meeting to order at 8:35 am.
2. Roll Call: Committee members present: Freeman Fong, Steve Goldblatt, Daniel Williams, John Palewicz, Richard Prentke; Committee members absent: Ed Schwartz, Robert Stephenson, Steve Tatge; Board Attendee present: Rick Burke; Board Attendee absent: Jill Geary; Staff present: Aliye Aliye, Chris Bath, Richard Best, Mike Kennedy, Allen Mardock, Mike McBee, Steve Moore, Lucy Morello, Mike Skutack; Staff absent: Eric Becker, Melissa Coan, Sherri Kokx
3. Guests introduced themselves.
4. Committee members unanimously approved the May 12 and June 09, 2017 minutes.

Budget Update (Aliye Aliye/Richard Best)

1. Aliye Aliye, Capital Project Management Analyst, presented the overview of the June 2017 *BEX IV Program Cost Summary (Activity through May 31)*, the *BEX IV Other Facilities Projects Summar*y *(Activity through May 31)*, and the *BEX IV Budget Transfer/Changes Log*.
2. Richard Best, Director of Capital Projects & Planning, stated that Arbor Heights was initially moved ahead in the BEX IV schedule, which causes expenditures to outpace revenue, he noted that this was anticipated and planned.
3. Mr. Best noted that at the end of August after year-end fiscal closure, he will work with project managers and capital financial staff to transfer remaining project funds that appear in the BEX IV Program Cost Summery Report to the BEX IV Program Contingency.

Project Status Report/Board Item Reviews (Richard Best)

1. Project pictures, renderings and data are available on the BEX IV website: [BEX IV Reports]
2. Richard Best presented a PowerPoint showing the status of the current BEX IV projects. Projects presented included Cascadia Elementary School, Robert Eagle Staff Middle School, E.C. Hughes Elementary School, Loyal Heights Elementary School, Meany Middle School and Olympic Hills Elementary School.

Panel Discussion on Construction Costs/Project Escalation City of Seattle (Richard Best)

1. Richard Best introduced the panel members present to discuss Seattle construction market conditions, current construction costs and projected escalation Seattle Public Schools should anticipate for completing identified BEX IV/BTA IV projects and planning BEX V Capital Levy. Panelists included Mike Herzog, B-N-B Builders; Tom Cole, Cornerstone General Contracting; Tim Casad, Lydig, Construction; Rob Robinson, Skanska and Sharon Kennedy, The Robinson Company.

   Several days prior to the meeting panelists were provided with a list of questions that would be posed at the BEX Oversight Committee meeting, including

   - Seattle Public Schools had success (success defined project bidding within budget) bidding our projects February through April 2017, then market conditions for construction seemed to change almost overnight, early May 2017, what precipitated these changes? Are these changes permanent corrections or temporary?
   - As we look to the near future, next three years, what factors should we be considering when bidding our projects to insure our citizens that we are being good fiscal stewards of their tax dollars? How do we market are projects to attract bidders?
   - Rob Robinson – A project your firm is working was recently highlighted in the Kitsap Sun. "Jim Dugan of Parametrix, school construction consultants, responded to a question of why Central Kitsap School District has not experienced cost overruns in planning for its $220 million in bond projects, approved in 2016. District officials there made numerous adjustments to bring the Central Kitsap High School and Middle School project in close to budget, and they finalized designs before the dramatic surge in construction costs that's taken place within the past month. Dugan said the market is flooded with "smaller" projects, and there is less competition for contractors among larger projects such as Central Kitsap is planning." I found myself questioning that statement, as several larger school projects are currently being constructed, was CKSD's decision to utilize GC/CM construction fortuitous given current D/B/B market conditions. Are dramatic value engineering measures being proposed to keep the project within budget? All – Is GC/CM construction more viable procurement delivery method than D/B/B in a white-hot construction market?
   - Do subcontractors bid GC/CM trade packages differently than D/B/B work? If so, how?
   - SPS is currently planning our BEX V Capital Levy that will be placed before the voters in 2019 for collection in years 2020 to 2025. How might you recommend we escalate selected projects so that they are adequately funded (not compromising our technical standards) and are fiscally justifiable to our School Board and taxpayers.

A summary of panelists comments are included after the minutes.

Meeting Re-cap and Next Meeting Agenda Items (John Palewicz)

1. Summer Holiday (August 2017)
2. Next meeting will be September 8, 2017

Adjournment

1. The meeting adjourned at 10:30 am.

Panelists' summary of their comments concerning current Seattle construction market conditions, construction costs and projected escalation:

Mike Herzog, BNBuilders, *Chief Estimator*

Was inadvertently left off the e-mail requesting a one-paragraph summary of panel discussion.

Tom Cole, Cornerstone General Construction, *Chief Estimator:*

One thing is very clear- it will cost more for future projects seems to perennially be the storyline.

Below is an article in the DJC that speaks to what I mentioned about the potential expansion of downtown private work. This article is another in a narrative of positive predictions for Seattle and surrounding area. What I mentioned at the meeting is the impending work that appears to be lining up to follow the waterfront redevelopment. This will likely be a significant economic factor over the next ten years-, which is inclusive of your next BEX V period.

Couple that with all the associated private development following Sound Transit's expansion and the SEATAC airport expansion there seems to be a sustained economic boom in the cue for our region, all other things being equally accommodating.

Days of a linear year over year escalation calculation are numbered. Especially when it comes to calculating escalation beyond 24 months. That is a big reason we have migrated to using a "weighted scale" for calculating escalation for projects bidding beyond 18-24 months in the future. We would suggest the SPS committee give this method consideration in planning the next BEX V levy campaign.

One last comment- it terms of design build (DB) delivery. It would seem worth evaluating, given the right opportunity. SPS has a program and facilities requirements structure that may be a challenge for DB delivery, not to mention the community involvement/influence. If SPS went this route there has to be a clear expectation that it will be a beneficial stewardship of the capital funds, before any consideration is given to the "how". This could be a time consuming discussion and may not produce a consensus in the long run. Perhaps it could be applied to a "not educational" building project on a smaller, less program intense facility.

Mr. Prentke alluded to this in his comments about historic DB projects- warehouses. This is not to say we are averse to DB delivery. But one other consideration regarding DB delivery needs to be recognized from the outset. There will be a narrower field of competition for DB delivery based on the inherent qualifications it requires of the DB team. For a one off project similar to kitchen facility or maintenance facility that may be acceptable risk, but for a K-12 academic facility it would need close consideration given all the requirements of SPS in programing, facility function and community involvement.
GCCM still and will always be the optimal approach, especially when SPS brings on the GCCM in the predesign / early SD stage, where they can be the most effective. Alternative MCCM & ECCM delivery works very well, especially in escalating markets.

We are successfully utilizing these delivery methods with several K-12 district clients.

Tim Casad, Lydig Construction, *Chief Estimator:*

The construction market in the Pacific Northwest is extremely active. The activity is greater than it has been, even in the boom of 2006 and 2007, and the strain on the economics of construction is significant. There are a number of factors causing this surge including a major influx of people into the region (and the corresponding need for housing and support businesses), the growth of major businesses in the marketplace (Amazon, Google, etc.), major infrastructure improvements (Sound Transit), along with passage of billions of dollars of school bonds throughout the region. With this there are an unprecedented number of projects in the marketplace with a limited number of qualified general and subcontractors, as well as a shortage of labor. All these factors are driving costs higher as contractors are being more selective about projects they are pursuing, the competition on the hard bid/public market has been diminished as contractors have more opportunities to negotiate projects at higher fees with less risk, and contractors and subcontractors are able to demand higher fees and are doing so at a rate we have not seen before.

In the last 12 months, on elementary school projects, we calculated an approximately 10% per annum escalation rate in the region. This is almost exclusively a market driven increase as the pricing for commodities and materials has increased, but mostly in accordance with more typical market rates. For the future, I believe the escalation trend will continue through 2020 unless there is a major correction due to a geo-political situation, steel/petroleum shake-up, or some other major event. There may be some flattening of the rate if Owners begin to cancel or mothball projects, but there have only been inklings of this happening as most Owners are fearing that delaying projects may only drive up the costs should the market trend continue.

Rob Robinson, Skanska *Vice President/Project Executive*:

The current construction market continues to be extremely busy. In addition, for the foreseeable future, Skanska believes this trend will continue, if not modestly increase. We are currently tracking approximately $4.3B of private sector projects (office, multi-family, health care and corporate market sectors) that plan to start late '17, '18, and '19 in the Seattle/Bellevue areas. In addition, we are tracking approximately $5.0B of public works projects including those with Sound Transit, Washington State Convention Center, SeaTac Airport and other heavy civil WSDOT works - this does not include any proposed K12 market sector work.

The net effect on the market place is significant, specifically in abnormally high construction costs per square foot for typical K12 projects. In particular, the impact is primarily a result of increased subcontractor pricing. Many subcontractors are at capacity, and are only looking for high fee opportunity projects to bid on. Many are not taking on any further work, reducing the number of bidders, especially for masonry, glass/glazing, and gypsum wallboard. Based on informal surveys of a variety of K-12 subcontractors, we understand they are increasing their fees to: offset/protect against potential losses in labor due to unpredictable labor production (fewer quality tradesmen available); increased project management cost; and recapturing fees lost during the recession.

As noted in our panel discussion, we recommend SPS continue partnering early in the design phase with its General Contractors to develop strategies to ensure more predictable results. Suggest a majority of work be procured utilizing GC/CM delivery, with some selective D/B/B work, and consider using Progressive Design/Build (to increase collaboration, lock in earlier GMP's and reduce overall project duration). As for Escalation and Market Condition, we believe the strength of the market will continue through 2019 at an escalation rate of 3.5 - 4.0% per annum + 10% Market Condition per year. We anticipate that the market place will flatten, if not dip in 2020.

Sharon Kennedy, The Robinson Company, *Cost Consultant:*

Thank you for inviting me to the last BEX Oversight Committee meeting. I hope it was as informative to you and the Committee as it was to me. Although we all have slightly different or clouded crystal balls, it was clear to me that the current bidding climate; a reduction in competition from the general and sub-contractor markets, higher pricing and skilled labor shortages would likely exist for the next couple of years. The attached articles reinforce this. Just 175 miles apart, Seattle and Portland have 90 tower cranes in their downtown metropolitan area. There is 1.1 Billion in State Funded Capital projects awaiting release. The bid tracking list that we keep shows a 62% increase in the number of projects bid in 2017 than in the same time frame as 2016 (Jan-July – Western Washington projects only – No GCCM).

Currently we have eight to ten projects in our office that are scheduled to bid before the end of the year. In addition, about eight GCCM projects/bid packages either are out to bid or scheduled to bid before the end of the year.

There are some measures that can help mitigate poor competition and enhance contractor participation. If pre-bid walk through are mandatory, schedule multiple walk through so contractors can fit in their busy schedule. Consider reducing liquidated damages amounts, especially if substantial completion schedules are tight. Consider increasing construction schedules to reduce contractor risk of adding liquidated damage amounts in their bids. If bid alternates are extensive and/or include multiple subs within a single alternate, consider a Part A and Part B bid form and accept alternates minimum 1 hour later than base bid. Communication and outreach to general contractors is important.

In addition, an e-mail was sent to several local architects who listened to the panel discussion requesting they share their insights with the BEX Oversight Committee and the Board of Directors. The following narratives were received:

Caroline Lemay, Bassetti Architects, *Principal*

We attended a panel discussion about the current market trend organized by Seattle Public Schools last Friday, July 14. The panelists included representative from four prominent Seattle contractors and one cost estimator. The primary question was regarding how the district could better be prepared to face the challenging regional market conditions and how they can strategically place their projects on the market.

The following are notes from the discussion:

-Currently $7.5 billion bond projects in WA State.
-There is a clear lack of competition, from GCs to Subs and suppliers.
-Suggestion to allow for flexibility in the schedule (but all agreed that this was challenging for schools). This would mean that there are either available swing sites or that the school is prepared to slide the opening 6 months or 1 year. There are important cost impacts to this.
-If DBB (Design-Bid-Build) is used it is important to provide clear unit prices or allowances for undefined scope. This should provide tighter bids. Also, keep alternates simple and to a low number. Provide extra time to bid alternates within the bid timeframe.
-Provide incentives: i.e. increased mark-ups.
-Skilled labor (in all disciplines) is hard to find and is driving the cost up. An 8-10% escalation per year is expected.
-No end in sight with the current market conditions. Slight dip is expected in 2020 but market should rise again after this. (Vulcan is a driver of local construction boom, shortage in office space, Sound transit work, expecting 60 schools to bid in 2018…)
-Subs bonding limits are reached and often cannot take on more work. If the bonding requirement could be lowered, that might be a way to open more competition. However, this has to be a calculated risk for GC and Owner.
-Some labor union agreement are expiring soon which might drive costs even higher (plumbers just agreed to $24 increase over the next 4 years).
-From the panelist's perspective, hard bid (BDD) is not an interest. If they have their pick, they would chose to participate in a CMGC process over hard bid:

- Less adversarial,
- Lower change orders,
- More quality,
- Ability to forecast market movements and adapt,
- Capacity of buying material in advance - before cost increase,
- Predictability and buy-in to budget and schedule,
- Not tied to a low bidder, options to get the more qualified sub.

-Design-Build (DB) -traditional and progressive- was discussed as another potential delivery method:

- Need to provide a clear program from the start (bridging document) in traditional DB.
- Traditional DB is setup for little participation from the owner (no predesign). Predesign is done during the bridging document process.
- Since this would be a new delivery method for the district, it was suggested to create an oversight committee at the district level to ensure best practices are followed.
- Funding DB is difficult – consider self-funding projects if possible.
- Consider progressive DB: GC and architect as a team from the onset of the project allows for predesign process as part of DB.

Corrie Rosen, Mahlum Architects, *Associate Principal*

Thank you for inviting us to listen in to the panel discussion, there were numerous points that I not only brought back to share with our office, but am also looking forward to ongoing conversations since it seemed we only briefly touched on many subjects that have significant impact to our work that is due to bid shortly.

There were three main concepts that I brought back to our office. The first was the discussion of the Owner's role, two-fold. First in terms of thinking about strategies to reduce the GC's risk, or perceived risk and how the Owner could, potentially, share in some of the risks to reduce higher mark-ups. For example, with the issue of labor agreements for projects last several years. Should the owner help to mitigate this risk? Similarly, on another project we discussed whether sub-bonding requirement should be removed in such a competitive market. I appreciated hearing from the GCs that they felt that the requirement is imperative. The second piece was thinking about how the Owner can effectively market projects - setting "reasonable" budgets and consideration of the larger market and strategizing bidding since the issue extends well beyond the K-12 market.

The second discussion item was the design build discussion. While we only touched on this one, I think it prompted several questions. While the progressive design build method does not necessarily preclude things like the rich community engagement that is so much a part of the process, I think it alters it. It also underscores how important that the district's maintenance and operations, program, etc. requirements are identified at the outset.

Finally, I appreciated the discussion of how the current market conditions affect the BEX V planning and thought the concept of creating a separate "global" levy fund for escalation, in lieu of addressing it project by project is an interesting idea. I am curious to understand how other districts are addressing this issue as well.

Kevin Flanagan, Principal *NAC Architecture*

I was invited to attend a Seattle Public Schools BEX Oversight Committee meeting on construction cost escalation; this featured a panel made up of the lead estimators from BNB, Cornerstone, Lydig and Skanska, as well as Sharon from Robinson Company. This was a very interesting meeting, they addressed factors that affect all construction not just K-12 – these contractors work in multiple markets and they are dealing with subcontractors who also work in many different sectors. There was a fair bit of consensus at this meeting, my key take-ways were:

1. The construction workload (and related escalation) **will continue in the Seattle area through 2020** – drivers include: large transit projects continuing / starting, more large commercial buildings are in the pipeline, Vulcan has acquired large tracts of land for future development.
2. The cost escalation is being driven by labor; materials costs have been stable.
    a. The Labor agreements with several important trades are coming up this year and next, the new labor agreements will likely push labor costs higher.
    b. Seattle is certainly an epicenter of construction (3 years in a row with the most cranes in the US), trades and crews are being imported here to do work, but that comes at a cost premium.
    c. It is not unusual for workers to be paid above prevailing wage / union scale – to ether attract workers or retain them.

3. Escalation is hitting across all trades, there do not seem to be trades that are light or “better values”.
4. There is some concern that material costs, which have been stable, could have volatility that will increase escalation –there are no current signs of this, for now it is just one more thing they worry about.
5. Sharon acknowledged that the current rate of escalation is not sustainable over the long term, yet there are no signs of this abating (recognizing that political and geo-economic factors are wildcards that this panel is not qualified to address.) That said, the backlog for construction in the Seattle area shows busy construction through 2020.
6. None of the panelist showed any reasons why we should see some relief soon, only reasons why costs will go up.

Lisa K Johnson, *FAIA, DLR Group*

Problem Statement: Median cost per SF construction cost in the Puget Sound area is $500/SF. $7.5 billion bonds have passed in K-12. The tension is that it is likely that these bonds were not passed w/ budgeting to account for current costs.

All parties thought that a dip/market correction was going to happen at some point in the future, but thought that this was 2020 or after. Continued market saturation/growth is expected until then. In addition to K-12 bond spending above, in the region there is $4 billion in commercial work as well as significant infrastructure projects for Sound Transit and the Convention Center/ and a continued shortage of office space in Seattle/ Bellevue. There is a shortage of skilled labor among all trades. Cost escalation, as well as a shortage of labor in meeting schedules is a result.
Solutions discussed by the panel acknowledged that a partnership approach with the Contractor is key. Alternative Delivery: GCCM and D/B was a significant part of the discussion. The gist of the conversation was about managing risk and about leveraging different procurement methods to reduce the uncertainty of the market escalation by acting as early as possible. John Palewicz shared his expertise regarding alternative delivery from the University of Washington’s perspective.

In addressing BEX V, the question posed was this– Does the electorate have a level of understanding about the conditions of the market? Different strategies were suggested for how to plan for/budget the escalation due to market saturation, and perhaps how to describe/budget the costs. Certainly, it is anticipated that a voter reaction to seeing such high costs in future bonds may include some skepticism regarding “gold-plating” and overspending of taxpayer dollars.

Additional One-Page Summary
Submitted by Lisa Johnson

Overview of Problem Statement: Richard Best

- Median cost per SF construction cost in the Puget Sound area is $500/SF
- $7.5 billion bonds have passed in K12. The tension is that it is likely that these bonds were not passed w/ budgeting to account for current costs.
- How does SPS (and do other Districts) meet this challenge and their financial accountability? How do they do this and meet bond promises to the community?

Where is the market headed?(overview)

All parties thought that a dip/market correction was going to happen at some point (comparisons about 2006 market conditions to a dip in 2008), but thought that this was 2020 or after. Continued market saturation/growth is expected until then.

- Data shows a reduction of bidders, and limited competition.
- Communication/outreach to bidders and strategies to attract bidders were encouraged.

Specifics about current market conditions shared amongst the Contractors

- Skilled labor is a commodity.
- In addition to K12 bond #s above, in the region there is $4 billion in commercial work as well as significant infrastructure projects for Sound Transit and the Convention Center/ and a continued shortage of office space in Seattle/ Bellevue.
- In addition to trade availability, the ability of subcontractors to get bonded is an issue.

Strategies

- Partnership approach with Contractors is key.
- Alternative Delivery: GCCM and D/B was a significant part of the discussion. The gist of the conversation was really about managing risk and about leveraging different procurement methods to leverage time- reduce the uncertainty of the market escalation by acting as early as possible
- Expectations for school Design were briefly discussed
  - A question was posed that there was not time to address in this session, “Is our model for what a school looks like costing us money? This certainly would be a question that the voters will ask, that should be addressed perhaps as another topic (could be its own panel)

Next bond: How should this be addressed in 2019 BEX V to voters?

- The question posed was this– Does the electorate have a level of understanding about what needs to be done and the conditions of the market?
  - Different strategies were suggested for how to plan for/budget the escalation due to market saturation, and perhaps how to list this vs. embedding market costs with school SF costs
  - Communicating this, while expecting voter skepticism on high costs of construction (and wondering about “gold-plating” of facilities) was alluded.
  - This could be its own separate topic/panel.