

Construction Break

INDUSTRIAL • COMMERCIAL • INSTITUTIONAL • ECCLESIASTICAL • RESTORATION

FALL 2006

Managing Construction Costs

The Time To Build Is Now

Perhaps the following scenario will help to illustrate the challenges the construction industry has been facing with market escalation—or rapidly increasing costs—and show how construction executives are working to control costs and stay in business in the face of one of the most extreme inflationary periods in the industry's history:

A well-regarded architect is awarded a commission for a public works project, which has a generous—but not excessive—budget set by the client. He and his team design the project and, in the process, rely on relatively recent historical prices for similar projects, incorporating those numbers into his design to meet the client's specifications.

Then, when his design is approved and the go-ahead is given, he puts the drawings out to bid to several construction firms. The prices that come back are a staggering 25%-50%—even 100% more than the budget the client had originally allocated for the project. The designer is embarrassed—and angry. The client is upset. The finger-pointing begins and, in the end, the construction firms who quoted the project get a black eye, accused of predatory pricing, profiteering, and in some cases, even accused of lacking loyalty to a sector that had taken care of them in the past.

As time goes on, of course, the situation only gets worse. A year-and-a-half later, when the project is finally getting built, costs have continued to climb, resulting in price overruns and even more upset people—construction executives included.

So, what's going on?

One of the great untold stories of the late 1990s and early 2000s is that global competition for raw materials such as steel, lumber, plywood, concrete, drywall and insulation—coupled with a scarcity of skilled labor and skyrocketing premiums

for health care and construction defect insurance—blindsided the construction industry, causing double-digit increases in building costs. In fact, construction costs have outstripped inflation for the last three years in the West, causing some analysts to call it “a correction” for the inflation the industry experienced in the late 1990s but

which many firms simply absorbed, rather than passing on to clients.

According to Rider Hunt Levett & Bailey, in 2004, “Hawaii and California... experienced the greatest (average construction cost) increases of between 11% and 12%.” Even those figures seem tame compared to the 50% increases in the price of steel, 300%-500% increases in insurance premiums, and double-digit increases in the cost of skilled labor in parts of the West.

“The tough part about rising prices is that architects and clients have fairly stringent budgets to begin with,” says Walter Estay, AIA, a manager for Tate Snyder Kimsey Architects in Reno, Nevada. “Then, by the time the project goes through the design process and on to construction, it could be two, three, even five years later, with little, if any, adjustment for inflation or rising costs. We then have to either cut square footage, which impacts the intended purpose of the building, or we

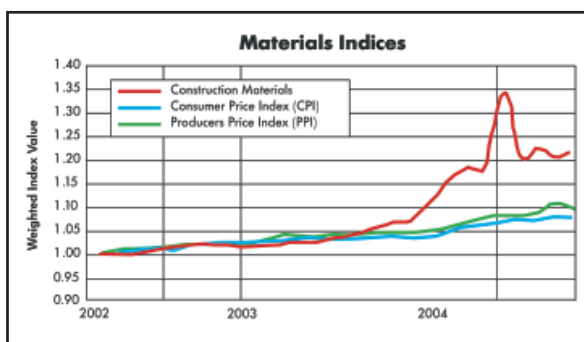
have to cut the quality of the materials used, which impacts the overall real and perceived quality of the structure. To avoid this, we're seeing more architecture firms instituting a contingency fee—typically around 3% per

year—but even that hasn't been enough in an escalating market.”

The good news, however, is that the escalation period is starting to taper off, and if you're

thinking about building, the time to build is now. Davis Langdon, whose analysis firm focused on the California market, was optimistic for the near term, saying, “We anticipate prices will begin to stabilize to a healthier rate of 6% per annum.”

So, how does a quality-minded construction firm manage those hard-to-come-by construction dollars? “The key is for construction executives to ensure their operations are as efficient as possible,” says Vaughn Prost, president of Prost Builders. “Scheduling becomes important. Locking in prices early becomes important. And, for our architect and designer friends, we advise them not to rely on old estimates to be realistic in the current market. Give us a call. We're happy to share our experience and expertise with anyone who asks us.”



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The new Hillcrest Hall conference room.

Stephens College's Hillcrest Hall Is Ready For Its New Students

Stephens College decided to renovate Hillcrest Hall's lower floor into a first class fitness center. The old dormitory kitchen and cafeteria areas have been converted into new changing rooms, a gymnasium, conference room and offices. The project allows the once dormant space to be useful again, enabling students to stay in shape with their very own fitness center. The project started last April and was completed in three months.



The new gymnasium lobby at Hillcrest Hall.



Employee Spotlight **Adam Garnett**

Estimator Adam Garnett strives to provide realistic, detailed estimates using the best pricing and quality materials available. His value engineering suggestions have saved numerous clients substantial amounts of time and money. He works hand-in-hand with all our clients to ensure that they receive the best possible building for their budget.

Adam has been with Prost Builders for three years, joining our team after graduating from Missouri Western State University with a degree in Construction Engineering Technology. Adam grew up in the construction business, working with his father and stepfather on commercial and residential projects.



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