

OFFICE OF THE CITY MANAGER

January 31, 2005

TO: City Council

FROM: City Manager

SUBJECT: Follow-up Issues Relating to the Funding of the City Hall Project

On Monday, January 24, 2004, the City Council discussed the award of a \$79 million contract to Clark Construction Group for the seismic upgrade and rehabilitation of Pasadena City Hall and the recommended funding plan to cover an additional \$24.3 million estimated construction cost. The City Council requested staff to return with additional information. This report is intended to respond to Council's request.

Item 1: Examine alternative measures to fund the General Fund portion of the project. Specifically, what would it mean to tap the Charter Capital Fund in the amount of \$6.9 million to \$7 million?

Response: The Charter Capital Fund has a current balance of approximately \$12.3 million. Per City Council policy, principal is preserved and interest earned on these funds is transferred to the General Fund to cover a portion of general fund debt service. Over the past three fiscal years, the Charter Capital Fund has earned approximately \$350,000 per year. Reducing the cash balance in the Charter Capital Fund by roughly \$7 million would reduce annual interest earnings to an estimated \$150,000, thus reducing annual revenues to the General Fund by \$200,000.

Item 2: Present the most recent General Fund Five Year Financial Plan

Response: Staff will present the most recent General Fund Five Year Financial Plan at the January 31st City Council meeting.

Item 3: What is the current General Fund debt service commitment?

Response: Attachments 1 and 2 represent respectively the total outstanding General Fund debt and the corresponding annual debt service. Please note that a significant portion of the outstanding debt service presented on the attachments are supported by non-General Fund sources. Accordingly, both gross and net numbers appear on both schedules.

Item 4: Should the City Council approve the financing alternative recommended by the City Manager, what would be the last opportunity for the City Council to make changes to the funding plan?

Response: The \$24.3 million of additional funds being requested will not be needed for the project until sometime in fiscal year 2007. As such, the City Council could approve staff's funding recommendation and then decide to replace one funding source with another. The Council would have up to 18 months to change or alter funding sources.

Item 5: What financial resources are required to begin/complete a possible Phase I group of improvements to the electrical distribution system?

Response: Over the past several years, the Water and Power Department has added approximately \$10 million per year to the capital improvement budget to fund various capital needs for the Electric Utility. These funds have been added each year within the Utilities' current rate structure. Given past staffing levels, approximately 50% to 60% of these funds have been spent each year. In fiscal year 2005, the City Council authorized staff to supplement current staff with the use of outside contractors in order to complete a larger portion of the capital improvement program. For fiscal year 2006 the Department is proposing to increase the level of planned expenditures to approximately \$21 million. The majority of this increase is associated with what could be termed Phase 1 of the Distribution Master Plan, with emphasis on repair and replacement of transformers, cable, switches, circuit breakers and vaults; substation upgrades and construction of a system for containing any oil spills which might occur at the T.M. Goodrich receiving station.

Given the current and available cash balance ("working capital") in the Light and Power Fund, which as of June 30, 2004 totaled \$38.2 million, it is possible to fund this increased level of expenditure and make the additional \$8.6 million contribution to the City Hall retrofit project staff is proposing. Nevertheless, in future years as the Department increases the amount of capital improvements being performed annually the portion of utility rates associated with the distribution system will need to be adjusted to account for the financing of such

improvements. This would occur regardless of the financing proposed for City Hall.

Item 6: What would be the impact to the Light and Power Fund if in addition to the proposed \$8.6 million transfer an additional \$8.6 million were to be transferred in fiscal 2006?

Response: Staff is recommending that \$8.6 million be transferred from the Light and Power Fund to the seismic retrofit project. Based on the \$38.2 million working capital figure mentioned above, this action would leave the Light and Power Fund with a balance of \$29.6 million. Stated another way, the proposed action would reduce the working capital from its current 3.1 months to 2.4 months. It is important to note that the current working capital balance has accumulated over numerous years and that the Light and Power Fund does not generate \$8.6 million in "profit" each year. Were the City Council to transfer an additional \$8.6 million in funds from the Light and Power fund in fiscal 2006, the affect would be to reduce working capital to a level equivalent to approximately 1.7 months. The precise impact would be based upon the actual financial performance of the electric utility for fiscal year 2005. Given staff's intent to recommend an increase in the amount of funds budgeted for capital projects in fiscal year 2006, as discussed in item 5 above, transferring an additional \$8.6 million from the Light and Power fund to the General Fund for the City Hall project would leave sufficient cash to perform Phase 1 of the Distribution Master Plan, but would reduce the Light and Power fund's working capital level below the City Council's Reserve Policy.

Item 7: Could the proposed additional transfer from the Light and Power Fund be in the form of financed debt in order to maintain a level of working capital closer to the current amount?

Response: Should the City Council wish to leave cash in the Light and Power Fund, but accept staff's recommendation that approximately \$9 million of the incremental cost of the City Hall project should come from the Light and Power Fund, the City Council could decide to include the \$9 million as part of any supplemental financing and charge the electric utility for a prorated share of the debt service. Based upon the current revenue generated, the General Fund transfer would have to be increased by .63% to generate approximately \$709,000 annually. Currently, the general fund transfer for City Hall is at 2.5%. The increase would bring the transfer to 3.13% annually for the next 26 years.

Item 8: Can the City re-bid the City Hall project and structure the bid as a cost plus proposal?

Response: There is no single definition for a "cost plus" contract in public contracting law, and "cost plus" contracts have traditionally been used in a federal contract setting where the scope of the project is uncertain to the point that formulating bids is unrealistic, for example cutting edge military equipment, as opposed to a construction project which has a defined scope.

City Charter Section 1002 requires that the contract for the City Hall project be awarded to the "lowest and best bidder" after competitive bidding. A process based upon the award of a contract to the fixed dollar bid of the "lowest and best bidder" does not lend itself well to a "cost plus" contract.

Nevertheless, there is no absolute prohibition in the Public Contract Code or the City charter/purchasing ordinance against a cost plus contract; in fact, the term or concept is not mentioned in either body of law. A cost plus contract, or a contract with cost plus provisions would be allowable to the extent it were awarded on the basis of the fixed price or fixed bid formula of the lowest and best bidder. By way of example, the City bids long-term contracts for supply of electrical distribution system cable with provisions that allow for the price to adjust based upon changes in the price of metal as specified by a quantifiable index, in this case, the American Metals Index. As part of the bid, bidders indicate how much their price will be above or below on a percentage basis, the index. City fuel oil is also procured in a similar fashion.

This system works well for the purchase of a single product or commodity. Developing a structure for a "cost plus" for a construction project as complex as the seismic retrofit of City Hall would be an extremely challenging and lengthy process with no guarantee that the structure would function well in the marketplace. Moreover, a "cost plus" contract for construction would have many potential risks: it would be difficult to audit; contractors would have incentives to inflate costs in order to increase profits; there may be uncontrolled overtime shifts and pay necessary to "meet the schedule" and, material prices would not be fixed.

Item 9: Are current prices an anomaly and if we delay the project for one or more years may we see a decline in costs?

Response: Based on staff's analysis and analysis performed by other organizations, the current cost of construction is expected to increase from current levels for at least the next 2 to 3 years.

As outlined in Attachment 3 (California Construction Industry Market Escalation Report 2004 mid-year update, prepared by Davis Langdon Adamson), construction and cost escalations related to labor, material and equipment over the next two years locally show no signs of abating. Staff's research indicates that the factors contributing to continued cost escalations include: demand for construction, material costs, equipment costs and labor costs. Other factors such as a weakening of the U.S. dollar and higher than normal energy costs are also impacting the industry, albeit to a lesser extent, and are not expected to last as long.

In addition to the article cited above, staff has prepared a list of other articles, which have been reviewed by the Oversight Committee, relating to the construction and bid climate (Attachment 4).

Item 10: What does the funding plan for the City Hall project look like at \$93 million and what would it look like under the proposed alternative?

Response: Attachment 5 outlines the funding plan for the City Hall project at both the \$93 million level and the proposed alternative and then combines this information into a separate chart.

Item 11: What information do we have as to the past exploration of alternative projects, especially the demolition and reconstruction of City Hall option?

Response: Over the past 10 years, staff has explored numerous project alternatives. As outlined in Attachment 6, the following alternatives have been considered:

- Seismic retrofit via base isolation (four alternatives)
- Seismic retrofit main dome and build two new office wings (two alternatives)
- Seismic retrofit via structural shear walls (two alternatives)
- New off-site office building construction (three alternatives)

Item 12: Staff is currently showing a 10% construction contingency. What is staff experience on similar projects and will 10% be adequate to carry the project through to completion?

Response: While contingencies on similar projects are running 15% to 20%, staff believes that the proposed 10% is sufficient. Over the past year, building investigations conducted by staff have explored numerous underground and existing conditions that have resulted in redesign and changes to the plan


specifications. These changes have been included in the bid documents. Additionally, after all building tenants were relocated to off-site temporary facilities, acoustical dropped ceilings were removed and asbestos containing materials were exposed clearly identifying to bidding contractors existing conditions which may be encountered during construction. It is normal practice to limit the amount of site visits during the bidding phase of a project, however, staff on this project determined early on that it was in the City's best interest to allow unlimited access to the building up until the time bids were due. The refinement of the project specifications coupled with the additional access afforded to bidders works to reduce the uncertainty that typically gives rise to change orders. While staff has worked hard to limit the amount of unknowns in the project construction, City Hall is nearly 80 years old and there is no guarantee that some unforeseen condition may yet arise.

Item 13: If the City Council does not award the bid on Monday evening, what is the alternate plan?

Response: At the time of bid opening staff developed an alternative that would have lengthened the scope of the project into several phases. The first phase would have involved the construction of base isolators to complete the structural retrofit of the building. The approximate cost of this element of the work was estimated at \$53 million. This would have left approximately \$7 million for the City to begin work on the building code upgrades for mechanical, electrical, plumbing, and fire/life safety. This would have allowed us to build the backbone of these systems. At the completion of \$60 million, City Hall would be protected from seismic events, but could not be occupied due to building code requirements. In subsequent years, depending upon available funding, the City would have incrementally completed portions of the work in the hope of getting floors of the building certified for occupancy. This alternative would have resulted in a more expensive project because of the incremental nature of the work. In addition, the City would have been required to make lease payments for a longer period of time until the building achieved code compliance. This process could have stretched the project out an additional 5 to 7 years depending upon the amount of funding allocated to the project annually.

Staff will be present to discuss this information in greater detail at Monday's City Council meeting.

Respectfully submitted,


Cynthia J. Kurtz,
City Manager

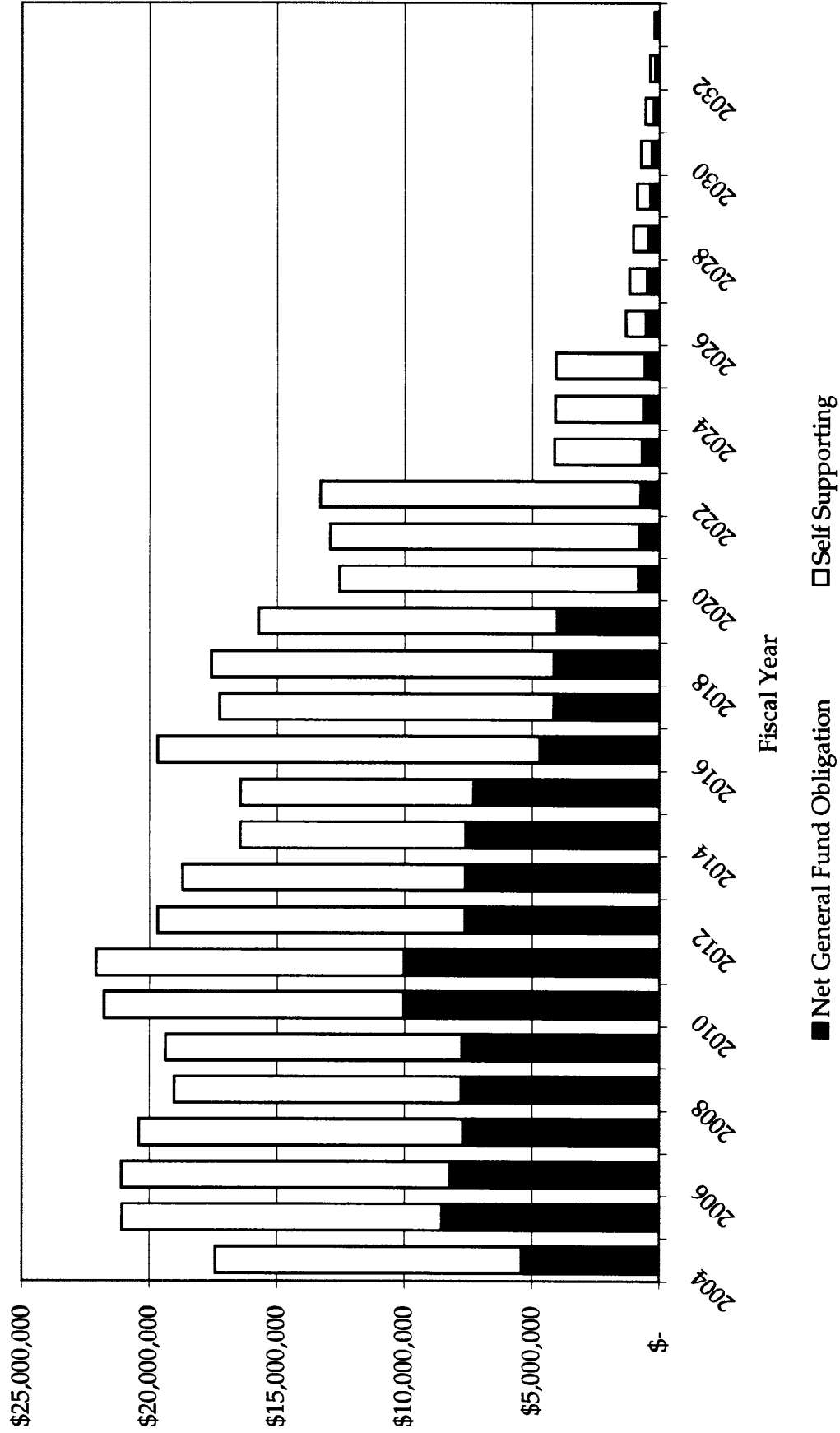
ATTACHMENT 1

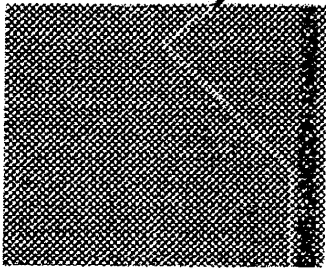
City of Pasadena Outstanding General Fund Principal Balance

Name of Debt	Total Principal Balance Outstanding at 08/30/04	Amount Paid by Other Funds	% Self- Supporting	Net General Fund Obligation at 08/30/04	Funding Source(s)
Business Type Activities (COP's)					
1987 Los Robles Parking Facilities COP's	14,100,000		100%		Transient Occupancy Taxes - Westin and Los Robles Parking Operations
1993 Refunding Old Pasadena Parking Facilities Project COP's	20,310,000		100%		Old Pasadena Parking Fund
Discretely Presented Component Units					
1991 Rose Bowl Improvement COP's	7,400,000		100%		Rose Bowl Operating Company Funds
1996 Rose Bowl Improvement COP's	14,800,000		100%		Rose Bowl Operating Company Funds
2001 Refunding and Capital Improvement COP's (Rose Bowl Portion)	328,413		100%		Rose Bowl Operating Company Funds
Enterprise Funds					
2000 Paseo Colorado Parking Facilities Revenue Bonds	31,035,000		100%		Paseo Colorado Parking Fund
1999 Marriott Parking Garage Note Payable	2,216,899		100%		Old Pasadena Tax Increment & Old Pasadena Parking Fund
2001 Paseo Colorado Equipment Capital Lease	1,040,271		100%		Paseo Colorado Parking Fund
1999 Equipment Capital Lease	2,896,009	2,397,611	83%	498,398	Portion Paid by Refuse, Computing and Communication, Printing and Mail Services Funds
2001 Capital Lease Property Purchase	3,552,859		100%		Equipment for Technology and Refuse Funds
General Fund Obligations					
1993 Police Building and Jail Refunding General Obligation Bonds	4,425,000		100%		Dedicated ad valorem taxes
1993 Refunding and Capital Projects COP's (Unrefunded Portion)	24,855,000	1,242,750	5%	23,547,627	Portion Paid by Sewer and Old Pasadena Parking Meter Funds
1996 Multi-Purpose Projects COP's (Unrefunded Portion)	1,325,000	751,805	57%	573,195	Portion Paid by Sewer, Old Pasadena Parking Meter, and Old Pasadena Parking Funds
2001 Refunding and Capital Improvements COP's (City's Portion)	15,346,587	1,577,920	10%	13,768,667	Portion Paid by Green Fees Fund
2003 City Hall and Park Improvements COP's	73,790,000		60%	29,516,000	Approximately 60% of the annual debt service is covered by the transfer from the Electric Utility
2004 Auction Rate Series A COP's	10,250,000	6,355,000	57%	4,407,500	Portion Paid by Sewer, Old Pasadena Parking Meter, and Old Pasadena Parking Funds
2004 Auction Rate Series B COP's	30,075,000		5%	28,571,250	Portion Paid by Sewer and Old Pasadena Parking Meter Funds
1999 Taxable Pension Obligation Bonds	97,850,000		100%		Downtown Tax Increment
	355,596,038		72%	100,882,637	

ATTACHMENT 2

City of Pasadena
 Aggregate Debt Service - General Fund versus Non General Fund





ATTACHMENT # 3

California Construction Industry Market Escalation Report

2004 mid-year update

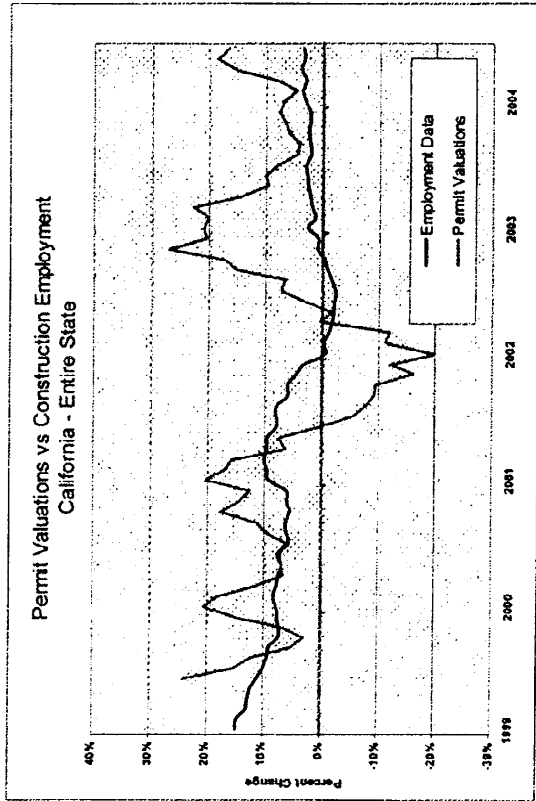
Overview of Construction Market)

Over the past six months, the demand for construction in California has continued to grow strongly, and the expectation is for continued growth over the coming months. In many areas, the demand has exceeded the capacity of the local market to provide responsive competitive bids for all projects. As a result, some projects are experiencing extremely high bids. It is not unusual for bids to exceed the anticipated cost by as much as 50%. In some cases, individual trade bids are coming in at two to three times the projected cost.

At the same time, some projects are receiving bids within the anticipated cost of construction, which indicates that there is not a consistent, universal increase in cost of construction, but rather a very erratic bidding market, heavily dependent on bidder interest, both at the general and at the sub trade levels. Within any one week, we have seen unit prices for similar trades on comparable projects vary by a factor of three.

Because of this wide variation in bid pricing, it is clear that most of the increase in the cost of construction is being pulled by demand, rather than pushed by cost. Whilst the costs of many construction materials have increased substantially, much of the increase has been fueled by demand, rather than increases in input costs. In other states, the material cost increase has driven an appreciable, but nonetheless moderate increase in construction cost. Most have not experienced the wildly varying bidding that has occurred in California.

We do not see any signs of a reduction in demand for construction services in California in the next two years. There are several major public and institutional construction programs in view, including the healthcare seismic replacement program, the State courts program, and school construction and renovation programs. Housing construction has shown little sign of abating, and the indication from the Federal Reserve Bank is that interest rates will rise very slowly to protect the weak recovery in other parts of the country.



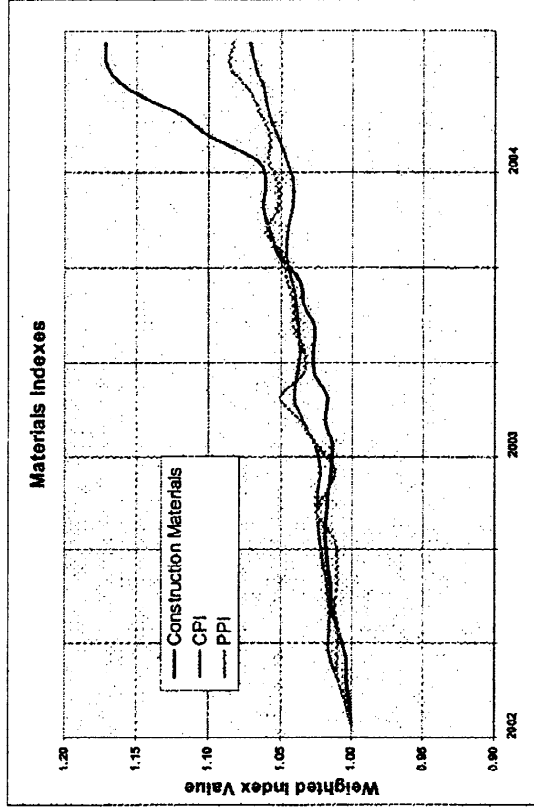
The Central Valley region has experienced the strongest increases in construction activity with a growth in construction employment in excess of 5% per annum. The Central Valley construction market is now almost equal in size to that of the San Francisco Bay Area market, and is much more active.

Southern California has experienced growth in the range of 4%, while the Bay Area has only seen growth of 1 to 2%. Permit valuations are showing strong growth in all regions, with a statewide annual growth rate approaching 20%.

Impact on Cost

Materials

Increases in material prices have been the headline story in the first half of the year. Where moderate increases were expected at the start of the year, we have now seen increases in individual materials of over 100%. Our broad based 'basket of goods', based on a weighted average of construction material prices, has risen by nearly 10% since the start of the year. This can be compared with the two broad measures of inflation, the Consumer Price Index (CPI) and the Producer Price Index (PPI), both of which have increased by less than 2.5% over the same period of time. The most dramatic increases have been seen in key construction materials such as steel, wood products and concrete, but almost all materials have experienced significant cost increases.



The rise in cost has been driven by sharp increases in demand for materials. Some of this demand has come from overseas, in particular Chinese demand has received a lot of attention. Domestic demand, however, has also played a significant part in the cost increases.

Perhaps more significant than the increased cost of materials is the uncertainty over what the cost should be. Prices have been changing so rapidly in many cases that vendors have not been able to commit to fixed prices. Contractors have therefore been required to submit fixed price bids without the ability to have cost certainty. In addition, suppliers have been unwilling or unable to commit to delivery schedules. As a result, contractors have had to absorb a high degree of risk in their bids, further increasing the cost of materials.

Many of the primary material spikes are showing signs of moderating, but there are few indications that material prices will fall. Demand continues to be strong, even as growth in China is slowing. Supply of most construction materials is relatively inelastic due to the time and expense of bringing new capacity on line, even where sufficient raw materials can be found.

¹ Data obtained from the Bureau of Labor Statistics (<http://www.bls.gov/data/home.htm>).

Overall, we do not anticipate a significant reduction in the cost of materials; the best that can be envisaged is a stabilization at the current higher prices. Delivery schedules will continue to improve, but there will remain a high degree of risk for bidders over the next twelve months.

Labor

Labor costs have been one of the quiet areas in construction escalation over the past six months. Wages have continued to grow at a moderate pace, and overtime costs have risen as construction volume is increasing faster than the workforce. Health care cost hikes continue to exert pressure on the cost of fringe benefits.

Burden

California passed a Worker's Compensation reform measure, which is expected to reduce rates overall by some 15%, as opposed to the increase of 12 - 15% which had been anticipated for the year, prior to the reforms being enacted. It will be some time before the full impact of these rates can be experienced by contractors, as they will typically only come into effect as policies are renewed. As a result, we would expect that the overall impact of the reform will be to reduce the cost of labor by approximately 3%, and the cost of construction overall by 1 to 2%. However, these reductions will take some time to come into play.

Productivity

A key element in labor cost is productivity. As the demand on the workforce increases, productivity typically decreases, as workers work longer hours, and less experienced workers join the crews. There is also a labor cost associated with the material delivery uncertainty. Bidders have to make allowance for lower productivity due to insufficient or out of sequence materials.

Overall, we see labor costs increasing steadily, at a rate of 3 - 5% per annum.

General Conditions / Overhead

As discussed above, the past six months have seen a significant increase in the risk undertaken by contractors, both on bid and on negotiated contracts. This impacts the general conditions in several ways. Site establishment and supervision costs can be increased due to delays in the supply of key materials or shortages of adequate skilled labor. Liquidated damages clauses can require a contractor to carry an allowance to cover the potential cost of delay penalties in their bids. In addition, many public agencies are experiencing freezes or reductions in their inspection or permitting staff, even while work volume continues to rise. This further delays projects and contributes to higher supervision costs.

We see continued pressure on General Conditions, both from the surge in demand for construction over the past six months, and from the general increase in costs due to added requirements being placed on contractors for quality assurance, project documentation, etc.

Profit

A major contributor to profit requirements is that of risk. As risk increases, contractors demand a higher premium to compensate them for their risk. As demand increases, and competition decreases, contractors are more able to realize the risk premium in their profits.

The construction market has become significantly more risky over the past six months, due primarily to the cost and shortage of materials, but also simply due to the increased demand on the available labor pool. Construction demand has allowed contractors to increase their bid prices to cover some of the increased risk.

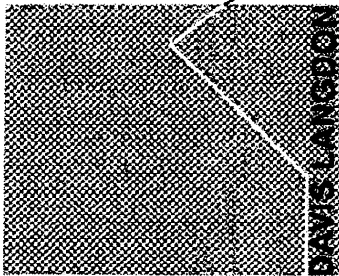
Conclusion

Overall, we believe that there is continuing substantial inflationary pressure on the construction industry in California, which is likely to continue through 2005, with broad based construction inflation in the range of 4 - 7%. In addition, we expect to see a continuation of the very erratic bid market, with many projects experiencing substantial bid overages. There are no indicators that would suggest that the current conditions will diminish in the short term. This creates significant problems for owners, since many projects were budgeted with the expectation of low inflation, and with little opportunity to absorb even the base inflation, let alone the erratic bidding currently being experienced. In addition, there is practically no way of managing the degree of bid variation through alternates or other bid risk management strategies.

It is essential, therefore, to examine the bid risks very carefully before proceeding with procurement. This can include evaluation of the pool of likely bidders, assessment of the attractiveness of the project, and identification of possible scope reductions or additional funding that may be available. In some cases, alternative procurement strategies, such as negotiated or guaranteed maximum price (GMP) contracts, or price fluctuation clauses may be appropriate.

For additional information please contact:

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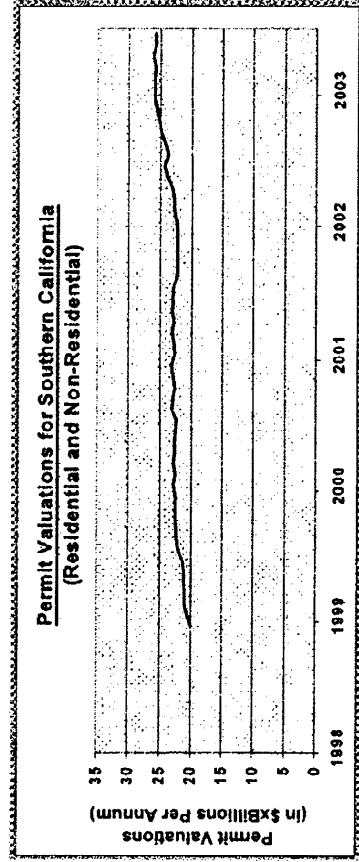
2004 Construction Industry Market Escalation Report

southern california
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Overview of Construction Market

We anticipate a strengthening construction market over the next few years, fueled primarily by health care construction and bond-financed public sector work. Private sector construction (offices and industrial buildings) is unlikely to experience strong growth, even as the economy improves, since there is still a large inventory of vacant property. Residential construction, which has been experiencing a small boom even in the wake of the poorer economy, is expected to slow but is unlikely to collapse.

The expected growth in construction across all sectors, however, is unlikely to overwhelm the market in Southern California¹, even with the strong health care demand to meet recent legislative requirements for seismic upgrades. While the health care backlog is estimated at over \$15 billion, it is likely that this will be spread over the next ten years as hospitals seek deadline extensions for the state-mandated upgrades, or choose to reduce capacity instead of funding expensive new construction. Based on these factors we do not expect the health care demand to exceed \$1.5 billion per year, or roughly 5% of the total construction market in Southern California².



¹ The Southern California area consists of Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, and Ventura counties
² Construction activity data obtained from Construction Industry Research Board (<http://www.cirbdata.com>)

Impact on Cost)

Cost for construction is impacted by a variety of factors, including materials supply and demand, the availability and cost of labor, general condition expenses, and accepted or expected levels of profit.

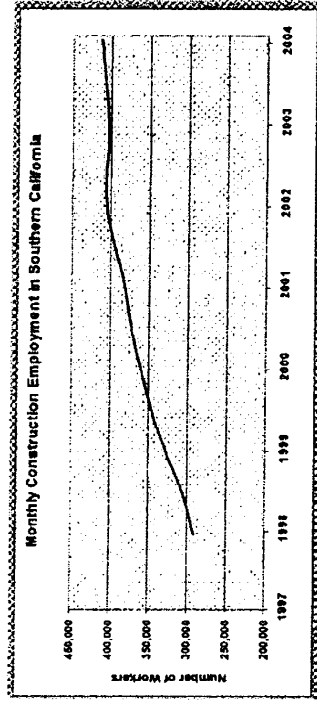
Materials

A 2 to 4% increase on materials cost is expected in the coming year. This small increase is expected due to the continued increase in demand for raw materials and manufactured items, as well as the expected steady increase in the cost for the raw materials required in the manufacturing process. Slow but steady increases in wage rates and cost of benefits are also expected to contribute to market pressure on materials cost.

Other factors can impact the cost and/or availability of materials. The currently weak dollar is causing significant increases in the cost of imported goods and materials. Taxes and tariffs imposed or removed will affect market pressure, as well as changes in material availability due to natural or political upheaval in source locations. These factors are more difficult to predict, due to the speed at which these changes can take place. The indicators are, however, that the dollar is likely to remain weak for some time, and world-wide demand for materials and goods appears to be increasing. This is leading to substantial increases in imported materials and products. Supply pressures on most raw materials are likely to remain steady or increase rather than ease, leading to a small inflationary pressure on domestic materials cost.

Labor

The following graph shows the construction employment history for the Southern California area¹.



Construction employment has maintained a strong growth curve over the long term, although this steady trend is showing signs of leveling. No pressure to reduce the construction industry labor force is expected in the near future.

Labor costs are further divided into wages, fringe benefits (such as health care), and burden (such as workers compensation and other liability insurance).

Wages As new union contracts are negotiated, expect an increased pressure toward higher wages. Due to the upturn in construction employment demand, contracts currently being negotiated include significant wage increases over the next few years. Typical increases are in the range of 4 to 7% per annum.

Fringe Benefits The most volatile area of fringe benefits is health care. The cost of health care has been increasing at a rapid rate over the past several years – 10 to 20% annually. These costs can now represent as much as 10% of the total cost of labor for the construction industry. Health insurance benefits and costs will continue to play a key role in exerting pressure on wage compensation in years to come, both with employees being expected to cover more of these costs on their own, and with employers being expected to contribute more. Since there is little sign of the rate of increase in health care costs abating, we expect that health care will contribute noticeably to construction inflation in the coming years.

Burden The primary component in burden costs is worker's compensation. Rates for worker's compensation insurance have been increasing sharply for quite some time, and in some cases now these costs can be equal to or greater than the base rate of pay for some subsets of the construction industry. While a rollback to lower rates is not expected, there is hope that by next year the rate of cost increase will slow to more manageable levels.

Even if costs are stabilized, however, the rapid increases of the past few years have yet to be absorbed into the bidding for major projects. We anticipate that worker's compensation costs will contribute markedly to construction inflation over the next two years, and possibly (to a lesser extent) beyond that time as well.

¹ Data obtained from the Bureau of Labor Statistics (<http://www.bls.gov/data/home.htm>).

General Conditions / Overhead

One of the inflationary pressures in general conditions is the continued transfer of risk and responsibility to contractors. Examples include the requirement for the provision of hand washing facilities on site, stringent quality assurance programs, and increased commissioning requirements. These increase the cost of supervision and site management for contractors.

General liability insurance rates have risen sharply in the past three years. This rate is slowing, but still represents a factor in inflation. Similarly, bond rates have also experienced large increases and diminished coverage, leading to higher costs and reduced competition among contractors.

Profit

Profit is entirely dependent on what the market will bear. In lean times a contractor may be willing to work with little or no profit margin identified, and instead focus simply on covering their fixed cost of operation. In better economic times, profit margins are significantly greater.

Profit is unlikely to be impacted by growth in competition, even during better economic times, since the supply of contractors is relatively inelastic. This is due to the high barriers for new contractors into the market, especially in the institutional and public sectors.

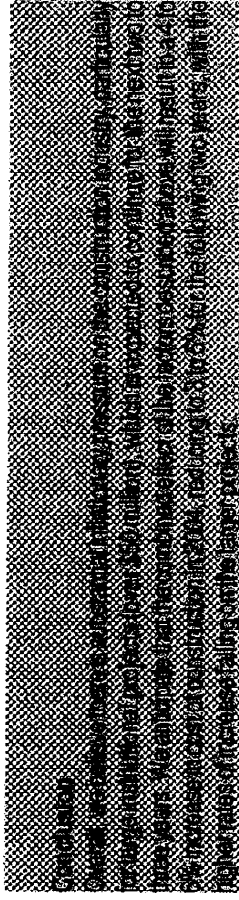
As the construction market in Southern California returns to sustained growth, it is likely that bidders – both at the general and subcontractor levels – will feel more comfortable increasing their level of profit. This increase could be substantial, particularly given the degree to which profits have been held low over the past two to three years. It is not unreasonable to expect to see increases in some sub-trades of 15 to 20%, and overall increases at the general level of as much as 10% of total construction costs.

Other Factors

Monetary inflation is one driving force behind escalation of the market. Code and practice changes can also have an impact on bid prices in two ways. The first is the direct cost of complying with the changes; the second, and often larger, impact is the perceived change in risk. Anticipated code impacts in the coming year are the adoption of the National Fire Protection Association (NFPA) code in lieu of the International Building Code (IBC) as the basis for California code, and the increasing

use of sustainable design criteria. Specific industries may also see practice changes. For example, patient care protocols for the health care industry are increasing both the building area required per patient, and the cost per patient to provide that building space.

These changes in code and practice can have a significant impact on direct cost of work, even though they need not be applied judiciously. There is, however, a perception – particularly among smaller contractors – that the work, and the accompanying documentation, is more difficult and thus considerably more costly to perform. In addition, owners often develop extremely onerous specification clauses related to changes in code or protocol that may result in unnecessary cost increases. Combined, the perception of difficulty and the weight of the specifications can lead to reduced competition, resulting in significantly higher bids. We expect that as these changes are incorporated into regular practice, these perceptions of added expense and risk will ease and impact on bid price will eventually become minimal.



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City Hall Seismic Retrofit Project

Market Analysis Summary

Attachment	Title	Source	Summary Recap
A	California Construction Industry Market Escalation Report, 2004 mid-year update	DAVIS LANGDON <u>ADAMSON</u> , Construction Industry Market Escalation Report 2004 (Mid Year Update)	Local Bid Climate. Market driven by demand, some projects receiving extremely high bids exceeding cost projections by 50%. Individual trade contractors coming in at two to three times project costs.
B	Figure 2-13 - Effect of Competition on Prices	<u>Area Cost Factor Study, U.S. Army Corps of Engineers</u>	Cost curve estimating bid factors anticipated when receiving two project bids.
C	Figure 3-11 - Comparing a Bid and an Estimate	Source not included	Cost histograms showing inflationary effect and cost escalations of later trade contractors.
D	Business & Labor Third Quarterly Cost Report Summary, Inflation Batters Building Costs	McGraw Hill Construction, <u>Engineering News-Record</u>	General commentary showing escalation costs for all construction goods and services have escalated dramatically over the past year and show no signs of abating.
E	Business & Labor Third Quarterly Cost Report, Equipment Fleet Owners Fire Up Capital Spending	McGraw Hill Construction, <u>Engineering News-Record</u>	Inflation effects on construction equipment costs fueled by high demand, aging equipment, higher fabrication costs.
F	Construction Economics, November 8, 2004 issue of ENR, Prices Rise for Concrete, Iron and Steel Pipe	McGraw Hill Construction, <u>Engineering News-Record</u>	Escalation costs associated with steel, di, pvc and concrete piping.
G	ENR's Materials Price Index (1983-2004)	McGraw Hill Construction, <u>Engineering News-Record</u>	General price index which shows percentage increases approaching 20% over the past 12 months.

City Hall Seismic Retrofit Project

Market Analysis Summary

Attachment	Title	Source	Summary Recap
H	Current Construction Market Analysis "The Perfect Storm"	<u>Cumming, LLC</u>	Market analysis overview of the entire state of the construction market.
I	2005 Construction Outlook for the U.S. and California	Outlook 2005 Executive Conference	U.S. Construction Market Indicators and Sectors covering Single Family Housing, Income Properties, Institutional Buildings, Public Works and Electric Utilities, Total Construction California Regional Picture and Points of Perspective

FUNDING SOURCES

Segregated by Funding Stages

	Total Appropriations	%
<u>Existing Funding/Appropriation Sources</u>		
1 Building Preventive Maintenance Fund	1,000,000	1.07%
2 California Heritage Fund Grant	100,000	0.11%
3 Federal Emergency Mgmt Agency	6,634,311	7.11%
4 Civic Center Parking Fund	119,000	0.13%
5 Information Technology Services Fund	800,000	0.86%
6 General Fund Portion - COP	26,590,056	28.51%
7 General Fund	3,336,767	3.58%
8 Power Fund	8,341,116	8.94%
9 Public Benefit Charge (Power Fund)	6,466,667	6.93%
10 Light & Power Fund Portion - COP	39,885,083	42.76%
Subtotal	93,273,000	100.00%
<u>Proposed Additional Funding/Appropriation Sources</u>		
1 General Fund	9,321,083	38.33%
2 Light & Power Fund	8,600,000	35.36%
3 Interest Income on Light & Power Portion	400,000	1.64%
4 Fundraising, Donations, and Grants	6,000,000	24.67%
Subtotal	24,321,083	100.00%
Total Funding/Appropriations	117,594,083	

FUNDING SOURCES

Combined for Entire Project

	Total Appropriations	%
<u>Existing Funding/Appropriation Sources</u>		
1 Building Preventive Maintenance Fund	1,000,000	0.85%
2 California Heritage Fund Grant	100,000	0.09%
3 General Fund Portion of COPs	26,590,056	22.61%
4 General Fund - Cash	12,657,850	10.76%
5 Light & Power Portion of COPs	39,885,083	33.92%
6 Light & Power Fund - Cash	17,341,116	14.75%
7 Light & Power Fund - PBC	6,466,667	5.50%
8 Federal Emergency Mgmt Agency	6,634,311	5.64%
9 Civic Center Parking Fund	119,000	0.10%
10 Information Technology Services Fund	800,000	0.68%
11 Fundraising, Donations, and Grants	6,000,000	5.10%
Total Funding/Appropriations	117,594,083	100.00%

CITY HALL SEISMIC RETROFIT PROJECT				
Alternate Projects Studied				
		Project Description	Construction Cost	Total Project Costs
1		Recommended Project - January, 2005		
2	0	Full Seismic Retrofit (base isolation), Rehabilitation of Systems, Rebuild Arcade & Full Historical Restoration	79,899,000	117,594,083
3				
4		Alternate Projects - April, 2002		
5	0	Full Seismic Retrofit (base isolation), Rehabilitation, New Habitable Basement/Arcade & Full Historical Restoration	57,215,000	88,795,000
6	1.1	Retain Dome and Fountain, Build New Office Wings (structural steel frame)	51,643,000	92,415,000
7	1.2	Retain Dome and Fountain, Build New Wings (Concrete frame)	56,394,000	99,024,000
8	2.1	New Building Off-Site (low-end construction) ¹	25,794,000	42,203,000
9	2.2	New Building Off-Site (mid-range construction) ¹	28,823,000	46,401,000
10	2.3	New Building Off-Site (high-end construction) ¹	33,364,000	52,724,000
11				
12		Alternate Projects - October, 2001		
13	A.	No Seismic Retrofit, Rehabilitation of Systems & Historical Restoration	16,835,000	29,253,000
14	B.	Seismic Retrofit (shear wall), Rehabilitation of Systems & Historical Restoration	31,094,000	52,145,000
15	C.	Full Seismic Retrofit (shear wall), Rehabilitation of Systems, Historical Restoration, & New Office/Basement Wing	5,332,434	79,368,000
16	D.	Full Seismic Retrofit (base isolation), Rehabilitation of Systems, Historical Restoration, & New Office/Basement Wing	63,433,000	100,777,000
17	E	Full Seismic Retrofit (base isolation), Partial Rehabilitation of Systems, Historical Restoration, & New Basement/Arcade Wing	47,345,000	73,042,000

CITY HALL SEISMIC RETROFIT PROJECT				
Alternate Projects Studied				
		Project Description	Construction Cost	Total Project Costs
18	E*	Full Seismic Retrofit (base isolation), Rehabilitation of Systems, Historical Restoration, & New Basement/Arcade Wing	51,563,000	78,646,000
19				
20	Alternate Projects - June, 1995			
21	A.	No Alterations	-	-
22	B.	Seismic Retrofit (shear wall), Rehabilitation of Systems & Rebuild Arcade	40,000,000	41,400,000
23	C.	Full Seismic Retrofit (shear wall), Rehabilitation of System & New Office Wing	51,300,000	52,800,000
24	D.	Full Seismic Retrofit (base isolation), Rehabilitation of System & New Office Wing	54,500,000	57,400,000
25				
26	Note:			
27	1	Excludes new parking and land acquisition costs		