Current Construction Market Conditions Present Price Challenges To Owners and Design-Builders

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Forward pricing has emerged as one of the prime advantages of the integrated design-build project delivery method. Forward pricing is when the design-builder includes a guaranteed maximum price (GMP), lump sum or initial pricing as part its proposal or offering. Such pricing is based on a bridging document, design criteria package or performance–based specifications provided by the owner. Unlike conventional design-bid-build delivery, design-build forward pricing provides the owner with the benefits of early project cost information and transfer of cost risk. When reasonably undertaken, it provides the design-builder with clearly defined risks and an expected financial return on the project. Both parties benefit.

Today's construction materials and workforce cost escalation issues are forcing owners and practitioners alike to confront new challenges in reaching their individual pricing goals. According to the June 2006 issue of Engineering News Record (ENR), PVC pipe prices are between 13 and 27% above a year ago. Copper pipe prices doubled in some cities and are now between 40 and 80% higher than a year ago. The 20-City Materials Cost Index (MCI) for cement is up 8% from a year ago while steel is up 8.4%. Again according to ENR, wages are up 3 to 3.9%. An even bigger workforce issue is availability of skilled labor.

So, in the current construction environment with forward pricing involving early transfer of cost risk, owners and design-builders are assuming extra risk and extra costs. Selections remain price driven while extraordinary forward pricing challenges are becoming common. How can owners and design-builders best achieve their cost risk management goals? Several methods are being applied to reduce the effect of the "China Syndrome" as some are calling today's construction costs dilemma.

To the greatest extent possible, owners should remain focused on finding the best technical solutions to their project needs. One can pretty much be assured when comparing similar technical solutions offered by different design-build teams, that the owner would pay about the same for similar solutions. Basically, a 10 million-dollar solution is a 10 million-dollar solution. So the real challenge and ultimate focus should be on finding the best solution.

Of course, the hard reality of construction is that seemingly there are three important factors -- price, price and price. Public owners in particular believe that price evaluations are a required part of their fiduciary responsibilities. Prescriptive procurement statutes in certain states and locales drive owners to select based on price. Let's face it. Price as an evaluation criterion looks as if it's here to stay.

There is a way for owners and design-builders to set the GMP or lump sum pricing early by sharing certain cost escalation risks up front. Cost ceilings can be established above which the owner takes over

the upset condition cost risk. This does result in potentially higher project cost because of today's rapidly escalating construction cost realities and the design-builder's need to hedge inflationary risk.

Another very effective and perhaps most beneficial approach is to set the transfer of final cost responsibility later in the project cycle. A phased design-build project approach can be employed where cost responsibility is transferred upon completion of first phase final scoping and design. Phase I proceeds using a Qualification Based Selection (QBS) process to choose the design-build team based on qualifications, experience and proffered solutions. Phase I might ideally be complete when the design team has completed, say, 60% design, plus or minus. This allows the owner and the design-builder to remain focused on technical solutions and schedule before casting cost responsibility in concrete.

In QBS selections for design-build with a phased approach and the latest acceptable transfer of cost risk, the actual construction schedule will better match market conditions and will result in the lowest cost mutually derived solution. Waiting until the design is at some late stage of planning/design, say up to 90%, will further promote maximum collaboration and provide the owner with more input while paying less.

The collaborative process of the two-phased design-build approach promotes the owner's ability to participate in designing the final solution. One senior public sector purchasing professional in Florida recently told me she consistently hears from her project managers that they want more direct interaction with the designer in design-build projects. Owners not only obtain recurrent input on quality and schedule through the phased approach, they will likely pay less to cover design-builder price risks in a volatile construction market during the second project phase.

During the second phase, the owner and design-builder set guaranteed pricing and the construction part of the project contract proceeds. At this point the design-builder has its marching orders and can reasonably assume the cost risk.

There is evidence that larger organizations are moving toward this two-phased design build approach. QBS is also being used to keep project costs down and provided for forward pricing advantages. The City of Jacksonville, Florida has recently issued a QBS based request for the new 400,000 square foot Duval County Criminal Courts Facility.

Accepting early cost risk through forward pricing carries much greater risks than before. By working together, owners can continue to enjoy the benefit of forward pricing by better understanding and sharing cost risks up front and design-builders won't have to bet the company each time on inflationary risk to win projects. By sharing inflationary risk or, better yet, focusing on solutions through QBS selections and a phased design-build approach, forward pricing can be set at the right time in the project and will continue to be a primary advantage of integrated design-build project delivery.