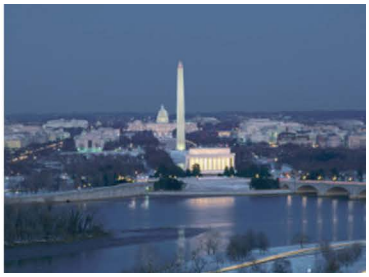


THE BROAD DIMENSION

the newsletter of tbd consultants - 4th quarter 2014

tbd consultants

Construction Management Specialists

111 Pine Street, Suite 1315
San Francisco, CA 94111
(415) 981-9430 (San Francisco office)

1663 Eureka Road, Roseville, CA 95661
(916) 742-1770 (Sacramento office)

9449 Balboa Ave, Ste 270, San Diego, CA 92123
(619) 550-1187 (San Diego office)

8538 173rd Avenue NE, Redmond, WA 98052
(206) 571-0128 (Seattle office)

2063 Grant Road, Los Altos, CA 94024
(650) 386-1728 (South Bay office)

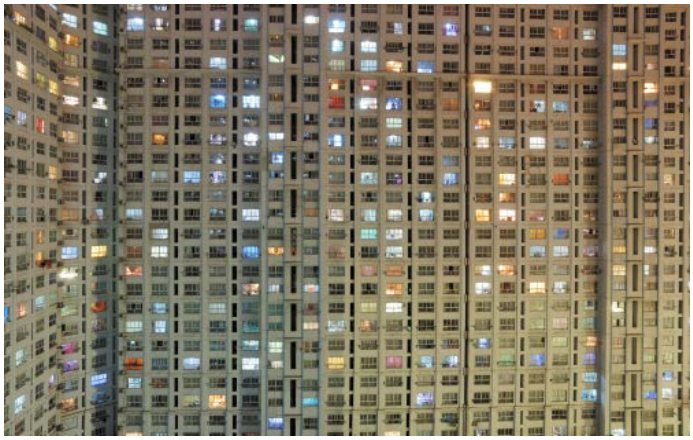
9705 Cymbal Drive, Vienna, VA 22182
(703) 268-0852 (Washington, DC, office)

www.TBDconsultants.com

In this Edition:

Condo Risk

Condo development was hit badly when the Great Recession hit, as were most other sections of the construction market, but while other sections are rebounding nicely, the condo market is lagging behind. What are the reasons for that?



One item that comes to the forefront is litigation. Unlike an apartment building that has one owner (or one owning corporation) that might instigate legislation for defects, a condo has owners for each individual unit, plus a home owners association, and any of those can bring a case. That has led some people to say that litigation on a condo project is inevitable. And while the case may start out over a specific issue, it is normal for the plaintiff's lawyers to initiate a survey of the building to ferret out anything that can be classed as a defect or code violation and add it to the case. In some states, the contractor has the right to remedy a defect before litigation is commenced, but that option is not available everywhere despite the efforts of some people to introduce it.

The cost of defending against such litigation can often substantially exceed the cost of repairing any defects, and that fact has been noted by the insurance companies. Consequently, the cost of insurance on a condo project can often be around three times as much as that for a similar sized non-condo construction project. One method that has been used to mitigate this risk is to design the project for future use as condominiums, but initially market the project as apartments until the statute of limitations for construction defects has expired.

The availability of financing has been a problem for all forms of construction projects since the financial meltdown occurred, but while banks are starting to move back into the market, they tend to be more reticent with regards to condo projects because of the higher risks involved. Where commercial banks are starting to consider construction loans for condo projects, they tend to require that the developers and contractors be long established, stable corporations, well used to this market sector. That is a good practice that we will return to later.

One method that developers have come up with to solve their financing problems is to demand higher deposit payments during the construction phase from potential owners. Whereas in the past a buyer might have had to put up 10% - 20% before the unit was ready, now it can easily range from 30% through 80%. This is good for the developer, because he may not need bank financing at all, or at least only at the later stages of construction. The buyer does run the risk of potentially losing a substantial amount if the development is not completed for any reason.

When litigation does occur, the contractor and the developer are obvious immediate targets, but the design team are also almost inevitably brought into the case as well. A case in California ended up involving the design team even when the contractual documents between the architect and the developer specifically excluded liability to subsequent building owners. But having clauses in the contract that define the design team's responsibilities and limiting liability to third parties is certainly recommended. It must be remembered that projects like condos have a lot of repetitive elements, so the design team may be paid for doing one detail that gets repeated hundreds of time, and if there is one problem in the design, it can lead to hundreds of identical problems in the building.

The practice that the banks have, of ensuring that the developer and contractor are long established, stable corporations, with a good history of condo projects, is one that the design team should use as well. If the developer is an LLC set up specifically for this project and is disbanded on completion, and the contractor has either gone bankrupt or otherwise closed up shop, the design team can be left as the only party the home owners association (HOA) can take legal action against.

Since code issues are obvious points for an HOA and its lawyers to pick on, having a code consultant on board for the duration of the project is advisable, and making sure all design consultants are current on codes for the state the project is in, is also essential. Ensuring that the budget is adequate for the project will help ensure that defects are less likely to be caused by cost-cutting methods.

It is possible that apparent defects are actually the result of poor maintenance of the building, so ensuring that the HOA is given a comprehensive maintenance manual, and is obliged to comply with it, is another good risk mitigation practice.

Using tried and tested building practices is one way of reducing the risk of construction defects, but the demands for energy conservation and other green building practices are pushing construction into new territory. For something like a condominium, the use of systems that require correct manual use by the residents is almost certainly going to result in problems sooner, rather than later. For instance, if providing adequate ventilation requires opening windows, then it is only a matter of time before mold starts to occur in some units.

Now that the economy is improving and more people have jobs, home ownership is becoming more fashionable and the condo market is becoming attractive and profitable once again. But good risk management is essential to ensure

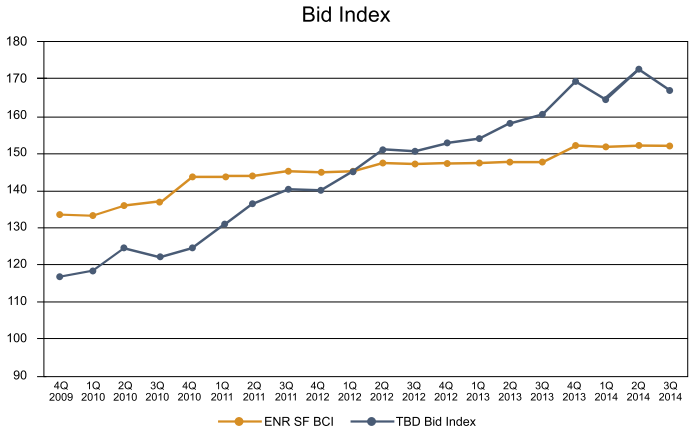
that profit is not only for the lawyers. The AIA has a white paper that includes 'risk management recommendations for condominium projects' available on its Web site.

Home and Abroad

The news from abroad has not been that great. The events in Ukraine seem to go from bad to worse, and Europe, which has a still a long way to go to recover from the 'Great Recession', is having its economic position made even worse by the sanctions against Russia, and Russia's retaliatory actions. The French cabinet ended up having to resign over the economic situation in France, and even Germany had a 0.2% decline in its GDP in the second quarter. On the bright side, there are some indications, and a lot of hopes, that the European Central Bank will start its own bond-buying program (like the Fed's QE2) to help stimulate growth.

The actions of ISIS (also known as ISIL or the Islamic State) in Syria and Iraq are causing huge humanitarian concerns, and also creating worries about the stability of oil supplies. And the Israeli-Hamas issue gives further concern about the stability of the region.

All of these concerns have been weighing on markets around the world, and have contributed to the slow-down in the stock market momentum in the US. But economic signs here still remain positive, and while the stock market cannot seem to make up its mind which direction it wants to move, it is still at or close to record highs at time of writing (end of August).



The employment situation continues its improving trend, although still not as fast as we would like, and certainly not as fast as Fed chief, Janet Yellen, wants to see. Companies seem to be reluctant to commit to too much investment in people and resources until they see more sustained growth, but that leaves us with a bit of a chicken-and-egg conundrum. But with Ben Bernanke saying that the banking crisis we went through in 2008 was actually worse than the one that set off the Great Depression (although its effects were mitigated better than in the 1930s), you can see why people might be a little wary still. Looking at CNN's Fear & Greed Index we see the needle is still a little way down the Fear side.

Nevertheless, all the signs for continued growth remain. Consumer confidence is up (largely, no doubt, because of the improving job market), company earnings have generally been good, and the GDP has picked up again after the effects of the severe winter dissipated. And in the construction industry, the continuing rise in the Architecture Billings Index (ABI) indicates more work down the line for all of us.

While the growth rate is not back to where it was, we'll take positive figures of any size.

Geoff Canham, Editor

California Schools Energy Boost

Starting in fiscal year 2013-14, and running for five years, about $550M is being allocated annually to the Clean Energy Jobs Creation Fund. Of that money, 89% will be allocated to LEAs (Local Education Agencies). These include county offices of education, school districts, charter schools, and state special schools. The remaining 11% goes to the CCCCO (California Community College Chancellor's Office). That money is for energy efficiency and clean alternative energy projects (including energy planning, training and management) in or at school or college sites and office facilities with the goal of reducing operating costs and improving health and safety conditions. In addition, $28M is being provided for low- or no-interest loans and technical assistance (for LEAs and Community

Colleges) to the California Energy Commission. $3M goes to the CWIB (California Workforce Investment Board) for a grant program towards training disadvantaged youth, veterans, and others for entry-level jobs in the clean energy and green building fields. Lastly, $5M goes to the California Conservation Corps for energy surveys and other energy conservation-related activities for public schools.

These funds are made available as a result of the California Clean Energy Jobs Act 2013, which stems from Proposition 39, approved by the voters in the November 2012 election. That changed corporate income tax code, raising taxes on out-of-state corporations operating in California.

Funding for LEAs is calculated as follows: 85% based on ADA (average daily attendance for prior year) and 15% based on number of students eligible for FRPM (free and reduced-priced meals program).

There are also minimum funding levels that apply, so the calculation for how much a LEA gets, is as follows:

Tier 1 (100 or less ADA) $15,000 plus FRPM allocation

Tier 2 (101-1,000 ADA) based on ADA (minimum $50,000) plus FRPM allocation

Tier 3 (1,001-1,999 ADA) based on ADA (minimum $100,000) plus FRPM allocation

Tier 4 (2,000 or more ADA) based on ADA plus FRPM allocation

LEAs with fewer than 1,000 ADA can combine funding for 2 years in the first year.

There is an 8-step process for LEAs to utilize their allocated funds:

Step 1: Give signed release forms to allow the Energy Commission to access the previous years' billing data and on through 2023 for all electric, natural gas, propane and fuel oil accounts for all of the LEA's schools and facilities (not just those planning to utilize Prop 39 funds).

Step 2: Benchmark the energy usage for facilities that will use Prop 39 funds, the benchmarking to include energy-cost/square-foot/year and Kbtus (thousand British thermal units)/square-foot/year.

Step 3: Prioritize the list for energy projects (i.e. what gives the best bang for the buck).

Step 4: Sequence the improvements, starting with those that maximize energy efficiency (such as daylighting or energy management systems, upgrading HVAC systems and water heaters, even replacing windows), followed by clean energy generation (e.g. photovoltaics or solar water heating), and finally projects using nonrenewable resources (such as a natural gas-fueled fuel cell).

Step 5: Identify eligible energy projects by utilizing an energy survey, an ASHRAE Level 2 energy audit, or data analytics (a Web-based virtual energy audit), as appropriate.

Step 6: Determine the cost effectiveness of the proposed projects, realized over the life of the eligible energy project. Projects must meet a SIR (savings-to-investment ratio) of at least 1.05.

Step 7: Submit an energy expenditure plan to the Energy Commission for approval. The plan may cover one year or multiple years, and in the latter case it will be reviewed annually by the Energy Commission. As part of the plan, the number of trainees and full-time employees engaged in the projects will be considered, because job creation is another part of the program's goals.

Step 8: LEAs are to submit a report on project expenditure within specified time limits following completion of a project showing the actual energy savings, and they are to submit annual progress reports on all projects. When reporting the energy savings, the savings related to the individual project is to be shown, along with the savings for the school as a whole. Final reports shall also include information on the number of workers that were involved with the project.