



November 2, 2020

To: Executive Committee

From: Darrell E. Johnson, Chief Executive Officer

Subject: Measure M2 Next 10 Delivery Plan: Market Conditions Key Indicators Analysis and Forecast

Overview

At the request of the Board of Directors, the Orange County Transportation Authority monitors construction market conditions. Annually, a report on Market Conditions Key Indicators Analysis and Forecast is presented to the Board of Directors to provide insight into potential project delivery cost drivers that could affect the Measure M2 Next 10 Delivery Plan. An updated forecast has been prepared. A presentation on the results of this effort is provided.

Recommendation

Continue to monitor market conditions key indicators and their effects on the Next 10 Delivery Plan and provide updates to the Board of Directors as appropriate.

Background

On November 7, 2006, Orange County voters approved the renewal of Measure M (M2), the one-half cent sales tax for transportation improvements. The Orange County Transportation Authority (OCTA) Board of Directors (Board) continues to advance the implementation of M2 commitments by adopting a series of delivery plans. The delivery plans are designed to validate the ability to implement all projects and programs through 2041 as promised to the voters. The delivery plans consider the cost and timing of the transportation improvements, fluctuations in sales tax revenue projections, access to external revenue, and the use of bonding when necessary.

In 2016, the Board directed staff to acquire better insight into the construction market outlook. The intent was to provide insight into near-term construction market conditions in tandem with the revenue outlook to assist with prudent project delivery decisions. OCTA retained the Orange County Business Council (OCBC), led by Dr. Wallace Walrod, Chief Economic Advisor to OCBC,

and Dr. Marlon Boarnet, Professor and Chair of the Department of Urban Planning and Spatial Analysis at the University of Southern California.

The results of the initial analysis were presented to the Board in September 2017. The analysis identified several near-term cost indicators that could influence the construction market and, by extension, the M2 project delivery. These included: the pace of transportation construction programs in the neighboring counties (resulting in the strained supply of materials and workers), construction wage pressures, sustained low statewide unemployment, and residential construction demand. Overall, OCBC's analysis identified a strong potential that during the Next 10 delivery years, OCTA could experience an increasing cost environment.

Following the presentation, the Board directed staff to continue to work with OCBC to monitor and track the indicators and provide the Board with updates to cost risk factors on project delivery. In response, OCBC spent early 2018 analyzing trends and creating an Infrastructure Construction Cost Index (ICCI) model. On September 10, 2018, OCBC presented their ICCI model and their forecast for 2018, 2019, and 2020 cost fluctuation range to the Board.

Discussion

OCBC continues to analyze trends in material costs, labor costs, and general economic conditions and trends. Relevant data for each model component is analyzed to determine a range of potential cost impacts. The fall 2020 update provides a three-year forecast through 2023 and is summarized in Attachment A. The attachment also lists the forecasts from prior years for reference and shows how well the forecasts have held up. The full report on the ICCI model update is included as Attachment B.

The ICCI model is designed to be a forecasting tool, with scores indicating public construction forecast cost fluctuations. Index scores of two and three indicate somewhat normal inflationary environments. A value of four is a high inflation environment. A value of one is a low inflation/deflationary environment. Values of zero and five correspond to the extreme conditions observed in Orange County immediately before and during the Great Recession and the high cost inflation environment that occurred in the building boom years of the early 2000s.

Using the ICCI model, OCBC estimates a score of one in 2021 and 2022, and a score of three in 2023. An ICCI score of one represents a potential range of cost fluctuation of negative two to one percent, and a score of three represents a potential cost increase range of two percent to six percent.

OCBC Orange County Transportation ICCI Score, 2021-2023		
Year	Index Score	Range of Cost Fluctuation
2021	1	-2% to 1%
2022	1	-2% to 1%
2023	3	2% to 6%

The update points to tempering market conditions compared to the spring 2020 forecast as cost pressures have slowed in the most recent data available. For example, a change from a low unemployment economy to that of a high unemployment economy due to the coronavirus (COVID-19) pandemic has lowered the risk for higher labor costs. In addition, building permits in California have slowed down, and building material costs have stabilized. As in prior forecasts and especially with COVID-19, OCBC indicates that OCTA will also need to be aware and ready to respond to cost pressures that cannot be modeled. Examples of such forces include:

- Tariffs and associated effects on the cost of materials from the nation's changing trade policy;
- Regulatory requirements and changes that create additional hurdles during the bidding process; and
- Future potential economic shutdowns related to COVID-19 spread.

Overall, OCBC's analysis identifies a potential that during 2021 and 2022, OCTA is likely to experience a low inflation cost environment followed by a more normal inflationary environment in 2023. OCTA is well-positioned to take advantage of the low inflation cost environment, as the M2 State Route 55 Widening Project between Interstate 405 and Interstate 5 and will be seeking construction bids within this timeframe.

Summary

OCTA has prepared an update on construction market conditions to help with M2 project delivery planning. The update considers fluctuations in material costs, labor costs, and general economic conditions and trends. The Market Conditions Key Indicators Analysis and Forecast concludes that OCTA may experience a tempering cost environment in 2021 and 2022, with potential cost increase ranging from two to six percent in 2023.

Attachments

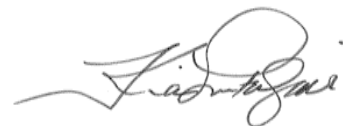
- A. Orange County Business Council, Orange County Transportation Infrastructure Construction Cost Index Score, Fall 2018 through Fall 2020 Forecasts
- B. Orange County Business Council, Orange County Transportation Infrastructure Construction Cost Pressure Index, Fall 2020, Prepared for the Orange County Transportation Authority

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