

The Current Bidding Environment of Commercial Construction Projects in Atlanta Georgia

Zuhair El-Itr, Ph.D.,CCE and Khalid Siddiqi, Ph.D
Southern Polytechnic State University, Marietta, Georgia, USA
zitr@spsu.edu, ksiddiqi@spsu.edu

Abstract

In a time of recession, general contractors tend to be very aggressive in bidding work in order to secure a backlog that will carry their operation and cover their fixed overhead. With the current economic slow down, the meltdown of the residential market, and the fact that most of the work available in the market is the one funded by the American Recovery and Reinvestment Act, the number of contractors interested in bidding public commercial work increased significantly. Bidding experience varies with some of the contractors having commercial knowledge with no understanding of competitive bidding and others having only a residential background. Since the playing field was not leveled, the bid market became like a jungle with players of different background, overhead, and qualifications, especially when the targeted project is small in size.

The study consists of analyzing twenty public commercial construction projects that were bid in the Greater Atlanta area between 2010 and 2011. The study will examine the increased number of bidders and its impact on the overhead and profit and on the spread of bids from the lowest to the highest. The profitability and health of the market is another area that will be analyzed in this paper by reviewing the lowest bidders and reviewing the rates at which they are able to secure jobs in today's economy.

Keywords

Construction Bidding, Public Bids, Bidding Environment

1. Introduction

After the meltdown of the residential market and the slowdown of the United States economy, there was a large reduction in the volume of construction work. The bulk of the active projects were publically funded commercial construction. A large number of contractors facing this new reality migrated to this construction sector and started bidding public projects. The lack of familiarity with this sector of the industry and the desperation mode in which contractors started bidding jobs created a depressed market where the winning contractors were bidding below their cost and way below Owner's Budget.

2. Methodology

Data was collected on a sample of twenty public commercial construction projects located in the Atlanta Metropolitan Area. These projects were public bids with public bid openings scheduled directly after bids were submitted. The projects varied in size from \$400,000 to \$2,650,000 with an average value of 1.2

million dollars. All twenty projects bid between July 2010 and March 2011. Projects were “Horizontal” construction, consisting of single-story buildings with a site component. The level of complexity of the work was considered low in general. However, some of the projects especially school renovations and upgrades, had a very compressed and aggressive schedule. School projects must be completed during the summer quarter. Most of the jobs had liquidated damages in their contract. Projects consisted of public libraries, community centers, fire stations, higher education facilities, school renovations and additions (K-12).

3. Basic Findings:

3.1 Number of Bidders: the number of bidders ranged from a low of four to a high of 26, with the average number of bidders on a project being twelve. Twelve bidders on a public project are considered a relatively high number.

- Four and five bidders happened on school projects that had a very aggressive schedule and must be completed during the summer quarter, i.e. (May 25-July 18). Contractors considered these projects as riskier due to the liquidated damages included in these contracts and the limited flexibility to accelerate the work should any problem arise during the construction process. These projects typically included electric work, HVAC upgrades, gymnasium and auditorium seating replacement, cabinet replacement, painting, and flooring. The work may sound simple however, the contractor must be very cautious in doing fast buyout and procurement. Planning, ahead of time, to receive all long lead items submittals and shop drawings should be done very early in the process. Timely deliveries are critical to the success of the project.
- On the other hand, there was twenty-six bidders on the Henry County Fire station, this outrageous number of bidders on a 1.2 million dollar project reflect two things: on one side, the bad status of the economy that makes contractors in a desperate need for work. On the other side, contractors look at a fire station as a simple project. The low perception of risk invites more players, especially new comers to the industry or players lacking significant experience.

Among the other reasons contributing to the significant increase in the number of bidders are the reduction in private sector work and the free fall of the residential construction during that period.

Reduction in Private Sector Work: after the financial meltdown, the banking industry became extremely conservative in their lending practice. The lack of finances reduced various development activities in the private sector. As a result, most of the contractors that, in a normal economy, pursued private sector work found significant reduction in the volume of project and went after the only work available in commercial construction mainly government funded work.

The free fall of the residential sector: the significant increase in foreclosure rate caused a significant decline in demand for new residential construction. This decline in demand channeled most residential contractors and subcontractors to pursue commercial work. Being new to this sector, they competed aggressively trying to “get their foot in the door” on government funded projects. They made mistakes,

due to the lack of familiarity in this sector. These mistakes caused all the players in the construction industry many problems.

3.2 Bid results

The cost of a project is the summation of the direct cost and the indirect cost associated with executing the project on site. The direct cost is the summation of all direct labor cost, material cost, equipment cost, and subcontractor cost needed to execute the various construction activities on the job site. On the other hand, the indirect cost or the site overhead or the general conditions consist of the cost needed to manage and execute the construction project on site. This cost includes the following:

- The salaries and benefits of the staffing and site supervisory personnel for the duration of the project (i.e., superintendent, site engineer, car reimbursement, etc.)
- The cost of facilities used to house site personnel for the duration of the project (trailer, temporary utilities, storage trailer, etc.)
- The cost of insurance to provide liability insurance and Builders Risk
- The cost of obtaining payment and performance bond through a surety company.

Lowest bid vs. cost: On the average, the lowest bid on a project was seven percent below cost. As expected when projects were perceived as risky, the number of bidder's decreases and the amount of discount below cost also decreased.

Variance between bids: On the average, the variance between the average bid and the low bid as a percentage of the low bid was approximately 16% and the variance between the average bid and the high bid as a percentage of the average bid was 16%. Making the variance between the low bid and the high bid as a percentage of the low bid more like 35%. This variance is very high and of course, it is a reflection of the market conditions and perceived risk factor of the job.

3.3 Current Market Composition

Difference between residential and commercial contractors and subcontractors: it is important to understand that there are many differences in business practices and make up between the residential sector and the commercial sector especially when we look at it from government funded project point of view. Among the differences that affect contractors pursuing publicly funded projects are the financial strength and managerial skills needed to properly operate in the commercial sector.

Financial Strength

- **Payment cycle:** at the end of the month of a commercial construction project the general contractor bills for all work performed during that month. Generally by the end of the following month the owner or architect will have reviewed, approved, and paid the payment. This sixty-day payment cycle is considered a good turnaround by many federal, state, and local government agencies. A ninety-day cycle is not at all far from reality. On the other hand, residential builders typically can ask for a bank draw as soon as certain construction activities have been accomplished in the field. Residential subcontractors expect to be paid within a week after their scope of work has been completed and passed inspection (when applicable).

This sixty day payment cycle necessitate that the general contractor have the proper financial strength to be able to take care of all his office overhead, his employee salaries, and all the payments for construction materials that are typically invoiced upon delivery to the project site. In order to lessen his cash flow problem, a general contractor will pass on that payment model to his subcontractor by including a “pay when paid” clause in all his subcontracts. Therefore, that cash flow burden of the payment cycle will be shared by the subcontractors. As a result, the subcontractor also operating on commercial construction projects shall have the financial strength to be able to take care of all his office overhead, his employee salaries, and all the payments for construction materials. On the other hand, the need for financial strength does not necessarily hinder a residential subcontractor from operating and participating in residential construction.

- **Retainage:** when submitting his pay request AIA form G 702/G703 the general contractor uses the percentage of completion of the various activities multiplied by the schedule of value for that activity in order to claim his earning for those tasks performed during the billing cycle. However, in computing the amount of payment due, the general contractor will deduct a percentage of the earning that will be retained by the owner until the job is 100% completed. The owner will maintain that retainage until the general contractor obtains a Certificate of Occupancy, submit all closeout documents, and satisfy all punch list items on that job. The amount of retainage may vary from one job to another however, in most cases on a government-funded project it is common to see retainage set at 10%. It is important to note that in a good economy and under normal circumstances, a general contractor’s combined office overhead and profit is between five and seven percent. Therefore, keeping 10% retainage and the payment cycle put a real financial stress on contractors especially in today’s market where profit margins do not exist.
- **Need for Payment and Performance Bonds:** This is a requirement for any government construction work that exceed fifty thousand dollar in value. This is another place where surety companies typically are looking for the financial strength, liquidity, and ability of a corporation to perform.
- **Managerial skills:** The commercial construction requires the bidder to go over a significant amount of paperwork before submitting a bid, which is not the case in the residential sector. Following are some of the managerial skill that are essential in operating a commercial construction business:
 - Knowledge of preparation of a detailed cost estimate and Lump Sum Bids
 - More sophisticated in scheduling
 - Intimate knowledge of blue print and specifications reading and local fire and safety codes

3.4 Market Confusion and Changing Practices

Fierce Competition: It is very common to see more than 20 bidders on a small project that is valued less than two million dollars. With such number of bidders, the competition is fierce and unfortunately, the lowest bidder is going to dictate at which price the project will be won. The general contractor that ultimately wins the project will not be able to make any profit in the process. Contractors are literally taking projects at or below cost in order to keep their door open and remain afloat. In re-iteration to what we mentioned above: cost means that the general contractor in bidding the job will cover all direct cost of labor, material, subcontract, and his general conditions and site supervision and site overhead. There is no fund allocated to support his office overhead and obviously any profit.

Bid Shopping: A General contractor main focus in today's market is to be the low bidder and to secure a contract. Once they are awarded a contract, they are in the driver's seat. They will go back and ask subcontractors and suppliers, who are also in a desperation mode, to lower their prices again, if interested in getting a "piece of the pie." It is very common to go through more than one round of price shopping and price cutting to close the gap in their bids to the owner. The bid shopping process between the general contractor and the various subcontractors is going to be mirrored and re-iterated between subcontractors, their second tier subcontractors, and their suppliers.

Change Order and Tense Relationship with Design Team and Owners: The winning contractor, in this market, has won the job at rock bottom markup prices. The job becomes cut throat to subcontractors allowing no room for absorbing any mistake in pricing or change in job condition that was not accounted for at estimating level; this situation created an unhealthy environment in which contractors (and subcontractors) are constantly seeking opportunities to make a profit through change orders.

Delivery Method: Cities, counties, and state government agencies when they were given the federal fund through the American Recovery and Reinvestment Act (ARRA) they were under pressure to earmark the fund to what was labeled as "Shovel Ready" projects. Therefore, in order not to lose the opportunity, the various agencies packaged many of their projects as Design-Build so that the jobs were awarded during the same year. Even though, the design-build delivery method may not be the proper vehicle for those projects nor the one that gives Tax Payers the best value.

Quality of the Bid Document: In other circumstances, owners wanting to meet the time constraint of the ARRA, pressured design teams to deliver drawing and specifications in a short period in order for jobs to bid and award dates to be established within the time constraint of ARRA. By compressing the design time, the bid documents that were initially issued to contractors to prepare their bids were seldom complete and had not been thoroughly reviewed by the design team prior to issuance. Due to the squeezing of the design process, the design team starts issuing changes to the original bid document in the form of an addendum all the way up to one day prior to the actual bids being due. This practice created lots of confusion on the estimating side: the general contractors have to make sure that all the suppliers and subcontractors submitting bids are working from the latest version of the bid documents and are acknowledging all addenda. The potential for error become even worse in a public bidding environment where the general contractor is receiving bids from companies, he never used before, minutes before bids are due to the owner, and he has to make a tactical decision to use or not to use their bids. This decision is even tougher to make knowing that each bid that he receives is also received by every general contractor in town competing on the same job.

Bids Coming Way below Budget: Due to the fierce competition in the commercial sector of the bidding market bids were coming significantly below their allotted budget in some cases as low as thirty percent below budget with a big variance between general contractors. As a result of this variance, owners started reviewing bid proposals with a completely different thought process. The current norm became that the contractor who "is the responsible apparent low bidder" does not necessarily secure an award. This issue obviously has some benefit but it definitely adds to the confusion of the bidders in the market place.

Criteria of Award Some owners became concerned about bid results. Historically, owners felt secure by obtaining a payment and performance (P&P) bond from a general contractor on all government jobs above fifty thousand dollars. The P&P bonds guarantees, through the surety company providing it, that the job will be completed, and that each entity that performed any work on the job will be paid in full. Soon enough, especially in a bad economy, where all players in the construction industry are feeling the financial pinch and are under pressure to secure jobs. Government agencies and public entities realized that awarding contracts to the low bidder who can meet the bonding requirement is not the best way to go about government business. As a result, they started adding all kind of criteria for bid award. These criteria added more complications and eliminated many players. That practice made sense in some cases but was completely irrelevant in other. For example, among the new added requirement were the following:

- Using a point system that evaluates the corporate financial standing, the value of the estimate, the proposed schedule, the staffing and resume of key employee allocated to the job. More subjective decision in this case is incorporated into the process.
- Requiring a minimum number of projects comparable in size and level of complexity and/or built over the last five years, “under the same corporate name.” Again some of these may be irrelevant when talking about a very simple one million dollar project.
- Requiring “audited financial statement” to be submitted by a general contractor bidding a two million dollar project. This requirement may sound as a limiting factor and “an over kill” on small job. The cost for an Audited vs. a Reviewed financial statement is fifteen thousand versus five thousand dollars. Obviously, this is a big limiting expense for a small size company doing less than ten million dollar a year in sales.

One may argue that some of the requirements were set randomly and do not necessarily benefit the project at hand. I recollect a one million four hundred thousand dollar shout-out house for one of the local police departments in Atlanta, Georgia. The project consisted of a pre-engineered metal building open on four sides, a shout-out house that should be provided by a sole sourced subcontractor, a concrete slab-on-grade, and a parking lot that include limited grading, curb and gutter and asphalt paving. The dollar amount was \$50,000 for the pre-engineered metal building (material and erection), \$50,000 for the foundation system and the slab on grade, \$800,000 for the shout-out house that was a sole source, \$100,000 for the electrical package. The bid was cancelled because the three lowest bid contractors did not meet the criteria set by the Owner on having at least five comparable jobs of same size and type over the past five years.

Abuse and Compliance with Bid Requirements-Davis Bacon Act: Since most local government projects were funded by the ARRA, as a result they required that contractors and subcontractors abide by the published wage rate under the Davis Bacon Act. The Davis Bacon wage scale is much higher than what most contractors and subcontractors are paying their employees in today’s market. Upon discussion with various contractors and subcontractors in this price bracket: we were told that meeting Davis Bacon and literally competing fiercely in this market won’t happen without falsifying some of the requirements. Subcontractors mentioned falsifying the set up of their crews for financial reasons. For example, one skilled laborer will be the technician that will meet his job classification under Davis Bacon Act and everybody else in the crew even when doing comparable tasks will be labeled as unskilled labor to meet the pay scale requirements.

Bidding More Work: in this bidding environment where being the responsible low bidder did not always translate to an award, General contractor submitted more bids in order to improve their opportunities of securing new work. However, in an attempt to control that overhead we start observing a large variance between the various bids that in most cases does not make any sense. As if some of the bidders were just “Throwing a number” without really committing the proper resources to do a detail costing and bidding for the project.

4. Concluding Remarks

During the United States recession most construction contractors migrated toward publically funded commercial construction projects. The number of bidders on a small job (1-2 Million Dollars) increased significantly. The lowest bid on a project was coming almost seven percent below cost and bids were coming way below Owner’s allocated budget. The variance between the lowest and the highest bid were almost 35%. In this environment of fierce competition between the various contractors in desperate need to secure work, contractors were bidding more work, bid shopping, and were using all kind of loopholes and tactics to get around bid documents and policies in order to have a competitive edge in the market. On the other hand, Owners were changing their customary way of awarding projects. They applied more pressure on Architects and Engineers to squeeze more time on the design process and sought different delivery methods to meet the ARRA time limitations.

5. References

- Giunita, F. (2009). “Low Bids – Beware”. The Construction Advisory Report, Fall 2009.
- Keller, R. (2010). “Commercial projects keep construction industry busy despite downturn in home building”. Southeast Missourian, January 3, 2010.
- O’Leary K. (2010). “The great recession: will construction workers survive”. Time Magazine in Partnership with CNN, February 06, 2010.
- Steil, M. (2009). “Low bids for construction projects both help and hurt”. A special program conducted by Minnesota Public Radio on Coverae of the U.S. Recession on line at <http://www.Minnesota.publicraio.org/Construction-lowbids>
- Vizard, S. (2010). “WIN-Win project delivery in a recession and beyond”. Online at <http://www.fminet.com>.