Sonoma County's Construction Sector:
Building for Our Future

November 2004

A report developed, researched and written by
The Sonoma County Economic Development Board
Ben Stone, Director

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INTRODUCTION

November 2004

The Sonoma County Economic Development Board is pleased to bring you its inaugural construction sector report, entitled "Sonoma County's Construction Sector: Building for Our Future." In this report you will find the latest available economic data on the status of the construction sector in Sonoma County.

This report is divided into two sections. In the first section, Economy.com's report provides a comparative analysis of the local and national construction industry. Their analysis compares county trends to state and national trends. Economy.com, a regular contributor to the EDB's Research Program, is a national leader in economic research and tracks regional economic trends in the U.S.

The second section is dedicated to the Economic Development Board's local construction industry report, entitled "Sonoma County's Construction Sector: Building for Our Future." This report highlights the results from our 2004 survey of local construction firms, and offers a brief overview of local current trends. The first part of Section II is qualitative, and includes an executive summary and report overview. This is followed by a quantitative analysis of the local construction industry, and includes graphical interpretations of the survey responses. Key highlights from the survey results include:

- Employment in the construction industry has increased recently.
- Winery and commercial construction are showing signs of growth.
- Most construction industry executives believe that there is a positive future for Sonoma County's construction industry.

Thank you for your interest in the Sonoma County economy, and for your support of the research conducted by the Economic Development Board. We welcome your feedback on this report and suggestions for improvements in the future. You can contact us at (707) 565-7170, or email us at edb@sonoma-county.org.

Yours sincerely,

Ben Stone
Director, Economic Development Board

Economy.com's
2004 Construction Industry Report

prepared by Steve Cochrane
for the Sonoma County Economic Development Board

Construction Industry - Sonoma County

Recent Trends. The construction industry in Sonoma County enjoys more stable conditions now than at any time during the past three years when weak demand and rising vacancy rates were the norm. Indicative of the improved climate for construction is an increase in the value of nonresidential construction permits issued this year through August.

Conditions, however, are not uniformly positive across nonresidential product categories or across locations within the county. For example, the availability rate for retail properties is a very low 3.1% according to Keegan & Coppin, and continued growth in retail sales bodes well for this component of the construction industry. But, availability rates for office and industrial properties have increased since the final quarter of last year, indicative of the still tentative rebound in local industrial and labor markets.

There have been virtually no industrial construction permits issued in the county since the beginning of the year according to figures from the Construction Industry Research Board. Office-space permit issuance has picked up, however, since this past spring, indicating some new supply for next year.

Housing markets also have stabilized as supply and demand move closer to balance. Permit issuance has edged upward from its low point at the end of 2002 although it remains at the low range of its historical average. Nearly all of the recent improvement has been in multifamily construction.

Construction employment stabilized in the county at the beginning of 2003, about six months before the rest of the private-sector economy leveled off. Neither construction nor other private-sector employment, however, has shown any significant improvement since then. Thus the overall assessment of the county's construction industry is moderate at best, but with some upside potential going forward.

Macro Drivers. Broad drivers of the construction industry are mixed, although positive factors outweigh the negative. Foremost is acceleration in private fixed investment spending nationwide to a remarkable 11% year-to-year growth rate in the second quarter, the strongest rate of growth in over ten years. Most of the growth has been in residential structures and industrial equipment, but even the growth of investment in nonresidential structures has been modestly positive over the past year. Further, new investment in equipment can be followed by new structures since there may be a need to house the new equipment.

A rise in venture capital placements also generates some upside potential for new demand for office and flex space as startup firms begin to hire and buy equipment. The pace of Bay Area venture capital remains uncertain, but the direction is upward. Third quarter placements were up by just 7% over a year earlier, although this was off a second quarter growth rate of over 30% according to PricewaterhouseCoopers' MoneyTree survey. While figures specific to Sonoma County are not available, its knowledge-intensive economy has always attracted a share of Bay Area VC placements.

A recent example of a new VC-backed startup is Legare Networks, which designs wireless telecom equipment. Its initial ten employees provide little boost to the demand for construction activity, but it portends future demand through growth. Indeed, former telecom startups that survived the lean years of the first half of this decade now are considering expanding their operations and bolstering their space needs.

The uncertain performance of U.S. stock markets lends some support to real estate investment and construction as investors seek higher returns. Combined with low interest rates it is a clear near-term driver for residential construction, and increasingly so for commercial and industrial construction as well.

Other factors, however, work to limit the pace of demand for new construction. First is the rapid improvement in nationwide productivity, which over the long term will maintain many comparative advantages for the U.S. economy, but in the near term results in workforce downsizing and outsourcing. Thus, space required per dollar of output is diminished and the trend to reduce the number of square feet of office space per employee dampens demand for construction activity.

Second, the prospect of higher interest rates will have a mixed impact on demand for residential construction. Given that the Sonoma County market is close to balance between supply and demand, that the economy is expected to improve with stronger employment and income growth, and that certain segments of the market such as retirement homes and high-end single-family homes depend less upon mortgage credit to support demand, construction activity should remain stable and could even be boosted moderately by a stronger economy. Any boost, however, will be limited by higher interest rates, ensuring that housing will be only a modestly positive driver to the construction industry in the near term. Economy.com expects interest rates on 30-year, fixed-rate mortgages to rise from their current near 6% rate to about 7% by the end of 2005 and 7.5% by the end of 2006.

Industry Drivers. Sonoma County's nascent economic recovery will support commercial and industrial construction. The improvement will be slow in coming, however, as available space has expanded since the beginning of this year. The rise in the availability rate has been the sharpest for industrial properties due to restructuring taking place in the area's telecom and tech-based industries. For example, cutbacks in recent months by Agilent due to a transfer of activities overseas, and similar plans by Medtronic for the near future have put large amounts of industrial space back on the market. The availability rate for industrial properties stood at 11% in the second quarter according to Keegan & Coppin, well above historical trend.

Long-term potential for the economy does arise from the availability of inexpensive industrial and flex space, reducing the friction that high real estate costs can have on both small startups as they expand, or on large firms as they face international competition. It is the ability of the county to remain a center of innovation for its driving industries, but particularly its specialized telecom and optics industries, that will generate steady long-term demand for new commercial and industrial construction activity.

Some evidence of this benefit is emerging. An example is the planned move before the end of this year of Dilithium Networks' headquarters from Marin County to Sonoma County. The availability of space at the former Gluon Networks building facilitated the move, which generates some near-term demand for renovation work. The real impact, however, comes longer term as such companies continue their expansion within the county.

Employment in office space-using industries has only just begun to turn around, and the outlook calls for a moderate rate of growth in the near term. Indeed, office-space employment, consisting of businesses/professional, finance and information services, had its largest single monthly gain in October since mid-2000. One month does not make a trend, but it is encouraging.

Available space, however, is expected to remain elevated in the near term. A rise in office construction permits issued through the first half of this year portends a rise in supply, so that double-digit availability rates may remain in the market for some time. Thus, even with improving employment conditions that generate demand for office space, the pace of construction is likely to remain moderate.

The steadiest demand for construction may very well come from the healthcare and education sectors. Local hospitals are expanding and the county's Cal State campus is adding facilities. Moreover, institutions such as these continue to grapple with bringing their buildings up to earthquake standards, which generates more demand for construction services.

Finally, long-delayed infrastructure improvements, such as the widening of Highway 101, generate good long-term potential for the construction industry.

Pricing. The pricing environment for the construction industry has begun to improve. The uptick in nonresidential construction permits since the beginning of the year is indicative of an increasingly competitive industry.

National figures indicate that the dollar value of awards per contract is improving as the size of contracts increases. Further, revenue streams are the strongest for firms with greater transitivity; in other words, with a greater ability to shift from commercial to residential to industrial projects. Such firms are better able to command higher prices in the market.

The lack of any significant acceleration of overall inflation and the desire among both private- and public-sector clients to keep cost increases to a minimum put some downward pressure on price growth, but with demand for construction rising moderately, some price increases are possible.

Operating Expenses. Input prices for the industry are also rising. Contractors face rising costs of cement, structural steel and asphalt. Steel is the most problematic; prices are down from recent highs, but price volatility still generates difficulties in accurately pricing out future projects. Global demand for building materials is very strong and rebuilding activity in Florida in the wake of this year's hurricanes is putting further demand pressure on prices for construction supplies. The impact is somewhat muted on the West Coast, but is still tangible and adds to the volatility of input prices for the industry.

Labor costs are less problematic, although a moderate gain on average of about 4% per year does put pressure on the bottom line. California's reform of workers' compensation costs is helping the industry, which has the highest workers' comp costs of any industry. Given the reliance on market mechanisms, however, it is uncertain how long it will be before workers' comp costs begin to rise once again.

Profitability. Rising costs limit the trajectory of profit growth, but with some ability to pass on these costs, and with the local economy expected to continue to improve, so will profitability. Sonoma County is expected to be one of the slower regions of the Bay Area to turn around, but those firms that can tap into the greater Bay Area construction market should benefit.

Volatility of major input components such as steel beams and copper wiring and sheathing will be most problematic for profits in the near term. Indeed, some contractors now will not even estimate such prices ahead but simply charge for actual costs upon delivery of supplies.

Long-Term Outlook. Sonoma County builders must still look to the long term for significantly stronger demand growth. Current excess supply will keep commercial and industrial construction rather light through the coming year. The second half of the decade, however, will offer more upside potential once the current inventory of industrial and office space is absorbed.

The outlook for residential construction over the long term should improve. Demand and supply are very nearly balanced once again in the local economy so that any improvement in employment and income growth should translate into expanded demand for new construction. This should occur more rapidly than the office and industrial market, which still has excess inventory. As long as long-term interest rates rise at a measured pace, their negative impact on the local housing market will be limited.

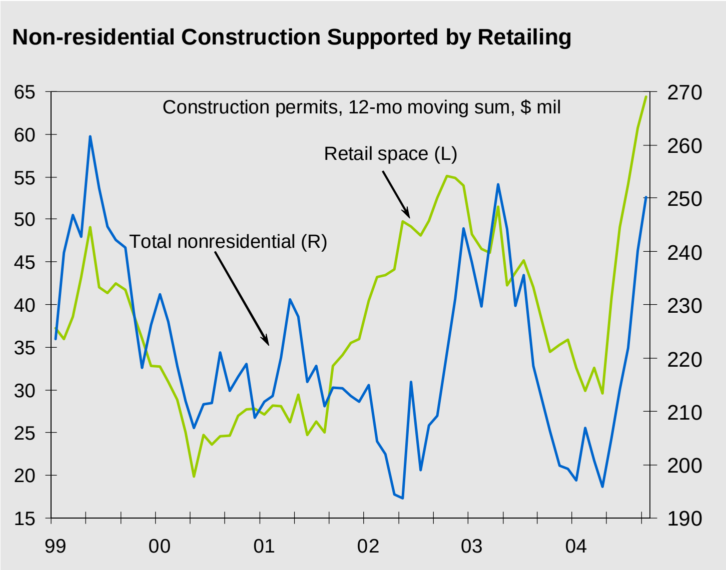
As rising interest rates work to limit growth of residential construction, so will state and local government fiscal difficulties work to limit growth of public construction. Local government in particular faces significant constraints, which will not be eased any time soon by a transfer of state funds to the local level. State finances will likely run a deficit once again in the coming fiscal year, although current revenue is running about 10% above expectations through October according to the state Controllers' office due to strong corporate tax receipts and improved personal income growth. The current pace of state spending, however, would indicate that deficits will continue well through the second half of the decade. Thus, there is little chance of an upside surprise on state infrastructure spending.

Upside Risks. Further upside surprises to state revenue growth could improve the outlook for public infrastructure support. Even more important, however, is the passage of Measure M on the Sonoma County ballot in early November ballot that will add ¼ cent to the local sales tax to support the widening of Highway 101, improve interchanges and support passenger rail service. Timing and scope of projects resulting from the new tax remain uncertain, but the funneling of funds toward the long-needed highway project will generate significant local construction activity, and more importantly, will improve the economic linkages between the county and the rest of the Bay Area, generating further comparative advantage for the county's economy over the long run.

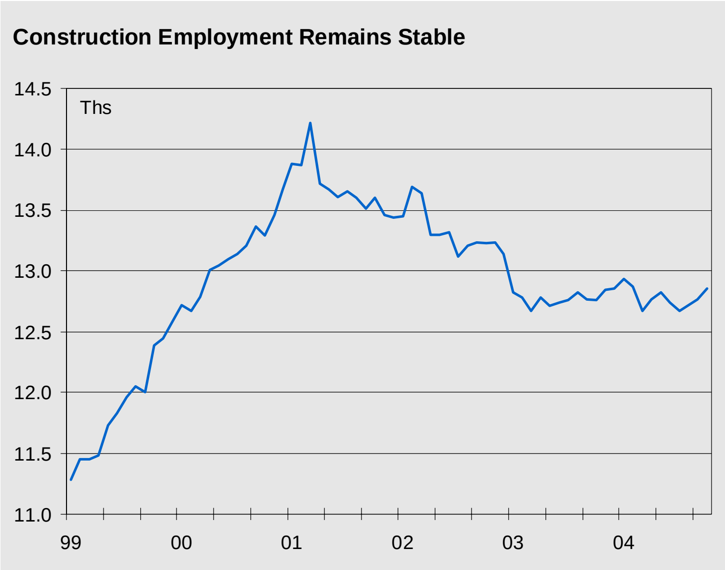
Downside Risks. Near-term risks are weighted to the downside as the economy could stumble over hurdles that would diminish demand for residential and nonresidential construction. A continuation of elevated oil prices could limit consumer spending and diminish the outlook for retailing. More significantly, uncertainty of oil and other input prices could also derail investment spending, which would be felt by Sonoma County's industrial economy and thus demand for industrial and flex space.

Steven G. Cochrane
November 2004

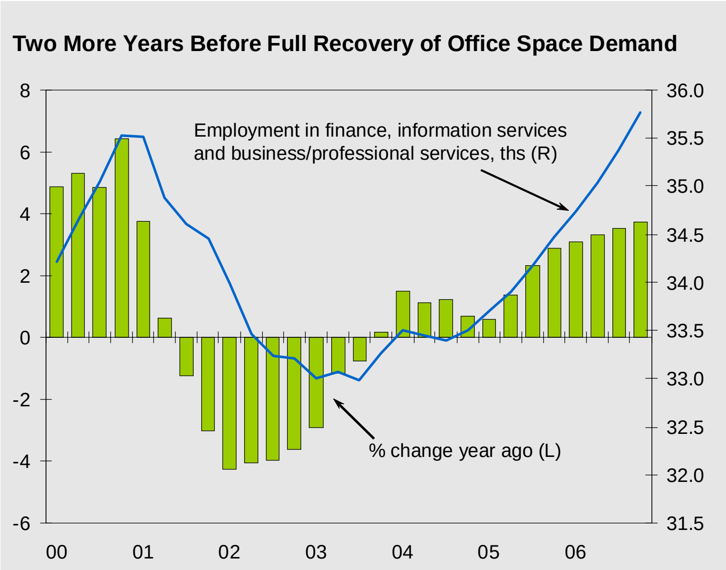
Construction Industry - Sonoma County



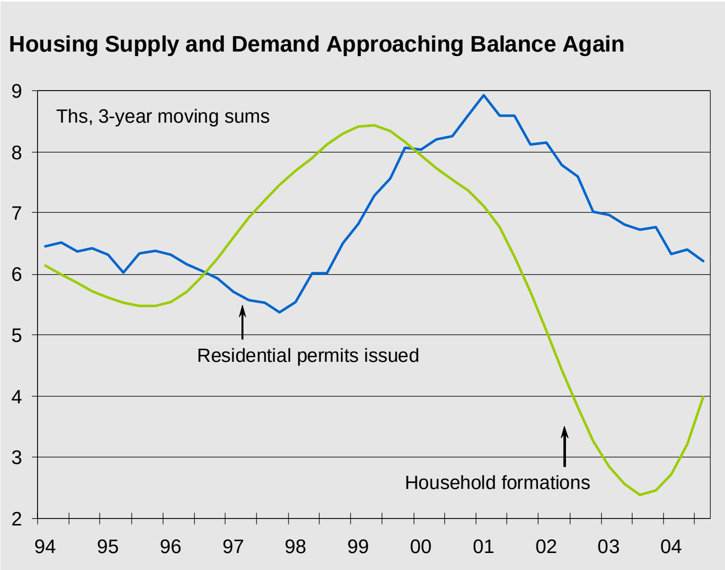
Permit issuance for nonresidential construction rebounded sharply this past year, but the turnaround was limited almost solely to retail space. There is a moderate amount of new office space under construction and virtually no new industrial space in the pipeline. Indeed, there is sufficient existing space for near-term demand, particularly for industrial space. The construction industry will be driven in the near term by public infrastructure, retrofitting and renovations, and to a certain extent by residential demand.



Constraints on the construction industry's workforce remain quite moderate. Employment remains well under the peak of three years ago and has remained level for nearly two years. Thus, wage pressures are moderate. According to the California Employment Labor Market Information Office, the mean hourly wage for carpenters in Sonoma County rose this year by just 1.0%, compared to a 3.2% rise in 2003. This helps offset the faster price increases in materials now faced by builders in both residential and nonresidential segments of the market.



Office market demand is likely two years away from full recovery. Office space demand has been tepid over the past year, and measurable growth is not expected until the middle of 2005. By then, the growth rate of office space-using employment will accelerate, although it will remain below the rate of growth seen prior to the 2001 recession. This projection would indicate that construction activity may accelerate in early to mid-2006 in anticipation of office demand surpassing its previous peak.



The housing market will be in balance before the office market reaches balance. Barring any unforeseen downturn in the economy, demand will be about equal to supply by early 2005. Thus, if the economy improves consistently and household formations accelerate beyond expectations, construction activity could accelerate next year. Our baseline forecast calls for a rather stable pace of 25,000 to 27,000 units of new construction permitted yearly through the end of this decade in the county. Risks to the downside come primarily from the possibility of significantly higher interest rates, which would stifle demand.

Sonoma County's Construction Sector: Building for Our Future

Executive Summary & Overview

Prepared by the Sonoma County Economic Development Board

Sonoma County's Construction Sector: Building for Our Future

In the Spring and Summer of 2004, the EDB surveyed nearly 1,000 construction firms located in Sonoma County to obtain information on industry trends and feedback on key issues affecting local companies. These issues include local economic competitiveness, workforce availability, and status of educational programs in construction fields. Nearly 25% of construction firms responded to the survey. This section summarizes key findings from the industry survey and identifies some opportunities to address the challenges facing the construction industry in Sonoma County.

Highlights from the 2004 *Sonoma County Construction Sector Report* include:

- More than seventy percent of survey respondents either increased or maintained their number of employees over the past year.

- More than two-thirds of survey respondents (72%) identified workers' compensation premiums as the most limiting regulatory issue affecting the construction industry.

- Over 95% of responding companies reported that the quality of transportation infrastructure in Sonoma County is increasing the cost of doing business.

- Seventy percent of companies reported that the cost of insurance on new projects in Sonoma County is prohibitive.

The Economic Development Board recommends consideration of several steps toward addressing many of the challenges facing local construction firms. The following key opportunities were drawn from survey findings, and are designed to strengthen the continued robustness of the local construction sector. The report recommends:

- Developing an ongoing forum that would afford the construction sector an opportunity to exchange ideas, disseminate best practices, and address common challenges

- Increasing public recognition and awareness of industry best practices and achievements.

- Working with local regulatory agencies to identify areas where the permitting process can be improved.

- Follow this inaugural study with a more in-depth survey that would analyze both the consumer/industry perspective as well as the permitting/planning agencies' viewpoints.

Overview

Industry Outlook

The following indicators are based on responses to the 2004 survey, and highlight several positive trends as well as challenges facing the construction industry in Sonoma County.

Optimistic Indicators

- Survey respondents reported a positive attitude towards future economic growth.

- Recent reforms of the State's workers' compensation system will lower costs for the local construction sector. Continued population growth in California increases residential construction demands.

- Winery construction and commercial building projects are rebounding.[1]

- Some key public works projects are continuing, despite State budget cuts

Impediments to Growth

- Poor fiscal conditions at the State and many localities threaten future public construction projects.

- Workers' compensation premiums have increased by 30% to 50%.[2] Premiums in California are now 2.5 times greater than the national average.[3]

- Transportation infrastructure in Sonoma County is aging and overused. Delays slow construction projects and increase costs.

- Local construction companies find that labor supply is reduced due to the high cost of living in Sonoma County.

Key Challenges

Licensing and Permits

Only 6% percent of survey respondents felt they were receiving an "excellent" level of service from regulatory agencies. Industry leaders and local governments can look for opportunities to find creative solutions for working together to address concerns about the licensing and permitting process within existing frameworks.

Skilled Workforce

Sonoma County's construction industry suffers from a shortage of skilled trades-people. Companies reported that many employees have left Sonoma County because of the high cost of living, while others are converting to more specialized careers. As a result, local companies are faced with a limited supply of skilled and experienced workers.

Hispanic immigrant workers play an increasingly large role in the construction industry. Opportunities to improve multi-cultural relations include recognizing the valuable role they play in the county's construction sector, and working towards improving both employer and employee bi-lingual capabilities.

Insurance Costs

High insurance costs are a major issue for Sonoma County construction companies. Ranging from workers' compensation premiums to general project insurance costs, the industry is facing rising costs, which can limit expansions and job growth. Reversing this trend can help sustain the construction sector in Sonoma County.

Potential Action Items

Construction Industry Forum

Many local organizations, such as the Home Builders Association of Northern California, North Coast Builders Exchange, Redwood Empire Remodelers Association, Northern California Engineering Contractors Association, The American Institute of Architects Redwood Empire and others, perform valuable service representing the construction industry in various aspects. However, no resource currently exists that can facilitate communication and cooperation among all facets of the local construction industry. Creation of an ongoing industry-wide forum for companies to share information, exchange ideas, disseminate best practices, and address common challenges could be a significant asset in supporting the construction industry in Sonoma County. A single point of feedback to local governments regarding the development review process may also increase efficiency and address some of the other problems raised in the survey.

Large and small companies alike from around the county could come together to discuss issues of mutual importance, such as customer service, workforce training and education, regulatory challenges, and more. Information and feedback shared in the forum could be documented in an annual report, which could serve as a resource for benchmarking progress and providing input to local governments and other industry groups. For various issues, public agencies could be invited to participate: e.g., regarding regulatory issues and local permitting services.

A possible model would be the Kentuckiana Construction Users Council, Inc. (KCUC), formed by members concerned about the availability of a properly trained, safe and costeffective workforce for their local industrial sites.[4] Options for developing the forum would need to be identified and evaluated according to the industry's interest and existing organizations.

Education & Training Programs

The following sections consist of summaries of a number of education and training programs arranged in part by the provider.

Education

The link between the construction sector and educational institutions/services continues to develop. In Sonoma County there are opportunities available for students throughout all tiers of education to obtain knowledge and experience relevant to the specific needs of local construction companies. Beginning in middle school, a small number of school systems across the county offer wood-working programs. Local high school districts also operate some basic wood-working classes with some construction applications. Additionally, the Sonoma County Office of Education Regional Occupational Programs (R.O.P) offers active training programs in 15 high schools across the county. R.O.P classes include Construction Technology, Cabinet and Furniture Making, Drafting Technology (includes civil and architectural), and Computer-Aided Design. All of the R.O.P. courses are directly linked to active industry advisory groups, and each course contributes to high school graduation requirements. In addition, R.O.P. courses in Agriculture are active in many construction industry segments including electrical, plumbing and welding. Many of these courses have articulation connections to advanced coursework at Santa Rosa Junior College and Sonoma State University. For example, Santa Rosa Junior College offers certificate programs in Construction Management Technology and Welding, while Sonoma State University offers a course in Construction Management in its extended education program.

The instruction of skilled construction techniques offered by R.O.P through the high school programs offers benefits in two basic areas. First, the local youth have a career path and skills, which translate to a strong financial base and sustainable earning power. Second, R.O.P. construction related courses offer students insight into the construction industry as a whole. Students are able to learn about and experience many facets of this active sector.

Construction Associations

Construction industry associations in Sonoma County are attempting to improve their connection with high school students by banding together to sponsor an annual "Careers in Construction" Expo in April 2005, organized by the North Coast Builders Exchange. This Expo gives hundreds of local students an opportunity to talk one-on-one with experts in the trade. This event also provides a forum for students to acquire first-hand information about job opportunities and salary levels in the building industry. Students, for instance, get to observe and participate in live demonstrations of typical industry work.

The Workforce Investment Board

The Sonoma County Workforce Investment Board, through its Youth Employment and Education Services Council, and the Sonoma County Office of Education are establishing a Work Readiness Certificate. This basic work readiness certification will assist in connecting students to entry-level employment in the construction industry. Students who attain Work Readiness status will show the business community that they approach the world of work in construction as literate employees, are able to calculate at an acceptable level, and have successfully undergone instruction in ethics and workplace problem solving. The construction industry advisory committee will be actively involved in assessing students and awarding Work Readiness Certificates.

Labor Organizations

In California, there are over 250 union-sponsored apprenticeship programs for the building and construction trades.[5] Apprenticeship programs allow people to earn wages while participating in a training program designed to enhance career prospects. The majority of apprenticeships provide training for construction sector jobs. In Sonoma County there are numerous apprenticeship programs including the Carpenters Training Committee for Northern California, and the Sheet Metal Workers Apprenticeship, among others, that provide craftsman training, organize career fairs, and outreach to local educational institutions.

In addition, the North Bay Apprenticeship Coordinators Association represents the majority of apprenticeship programs, and organizes trade and career fairs throughout the North Bay. These fairs afford individual trade apprenticeship programs the opportunity to outreach to students in high schools and junior colleges, informing students of the many opportunities for careers in the trades. For example, the International Brotherhood of Electrical Workers (IBEW Local 551) offers a five-year Inside Wireman apprenticeship program and a three-year Residential Wireman apprenticeship program in Santa Rosa. They also offer a one-semester, pre-apprenticeship program at Petaluma High School. Moreover, the IBEW Local 551, among other apprenticeship programs in the North Bay, is helping to organize a booth at the San Francisco Moscone Center on December 2nd and 3rd of 2004 to promote the value in apprenticeship training. Their latest project includes helping to establish “The Career Academy at Piner-Olivet” in Santa Rosa. The school has a career/technical focus, and is in its first year of offering a trades program for students in the grades seven, eight and nine. More information about local apprenticeship programs can we found on the North Bay Apprenticeship Coordinators Association website at www.calapprenticeship.org.

Online Permitting Systems

Government agencies receive approximately 100 million building permit applications every year in the U.S.[6] Some studies suggest that at least half of those applications could be processed online, which could result in significant cost savings. In fact, it would represent $130 billion of the $1.3 trillion construction industry in the U.S.[7] Other benefits of an online permitting system could include more time for government staff to work on problematic cases, decreased wait time for applicants, and a standardized review process.

At present some jurisdictions in Sonoma County possess their own versions of online permitting. These online applications operate individually by jurisdiction, providing applicants with different levels of service and permit availability.

Silicon Valley provides an example of increased efforts of harmonization in the online permitting process. Currently, eight cities in Silicon Valley have online permitting systems that allow property owners and businesses to submit plans electronically, check the status of their permits, and apply and pay for permits online. The system was achieved by pooling resources and expertise from cities, facility managers, architects and technology firms. The result is a significantly improved and streamlined development and permitting system.[8] Another model to consider is in the County of Fairfax, Virginia, which has introduced an e-permitting system to streamline the regulatory process.[9] In the long-term Sonoma County may benefit from a similar increase in availability of on-line permitting.

Endnotes

1 North Bay Business Journal 6/21/04 p27
2 Californian Construction Contractors Report
3 Sen. Chuck Poochigian
4 http://www.kcuc.org/
5 State Building &Construction Trades Council of California. “Facts about Apprenticeship Programs in California,” Internet accessed on 11/17/04, http://www.sbctc.org/default.asp?id=927&pagetype=hotissues
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Survey Results & Graphical Interpretations

Sonoma County's Construction Sector:
Building for Our Future
prepared by The Sonoma County Economic Development Board

Background

The construction industry is a cornerstone of the California and the U.S. economy. U.S. Department of Commerce data shows that U.S. construction activity totaled $898 billion, or 8% of gross domestic product, in 2003. In addition, the Bureau of Labor Statistics payroll figures show that the construction industry employed on average 6.7 million workers, about 6% of the private, non-farm, total last year.[1]

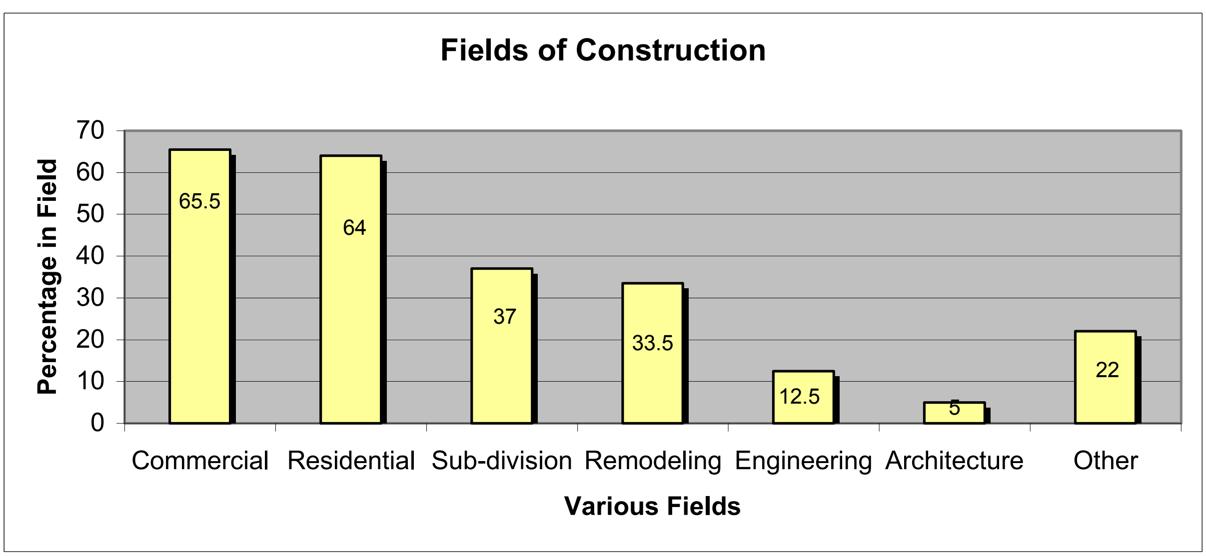
In 2003, California's construction industry submitted project applications worth an estimated $52.9 billion.[2] Residential construction accounted for $39 billion of this total, equating to 10.5% of residential construction for the whole of the United States. Non-residential construction permits issued to California companies totaled $13.9 billion worth of projects over the same 12-month period.

The Construction Industry Research Board (CIRB) calculated California's total construction activity for 2003 at $69.2 billion, up 7.8 percent from 2002. An estimated $69.8 billion will be spent on construction activity in California in 2004.[3] In a recent study by the California Employment Development Department (EDD), Sonoma County's construction industry is expected to account for an estimated 13,400 jobs.[4] This total is estimated to increase by 22% over the period 2001-2008, making construction one of the fastest-growing sectors of the regional economy.

Survey Results

Construction Sectors

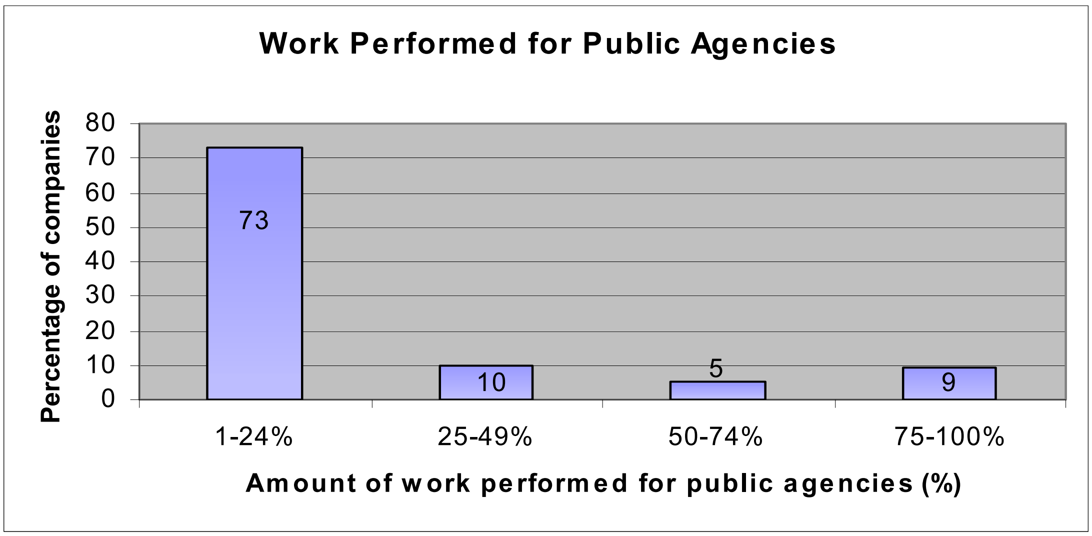
The Economic Development Board's 2004 Construction Industry Survey divided the 230 responding firms into seven different categories: Commercial, Residential, Subdivision, Remodeling, Engineering, Architecture, and Others. Respondents were asked to check all fields of construction that applied to their company.



Survey results show that the average construction company works in more than one field. Commercial and residential construction accounted for a significant percentage of the responding firms, due to their extensive and inclusive scope.

Publicly Funded Construction Projects

Almost all (97%) responding construction firms stated that during the past year they have relied on public agencies for building projects. The vast majority of these firms spent under 25% of their project time on public works, though 9% of companies working for public agencies stated that most or all of their time was spent on public sector projects.



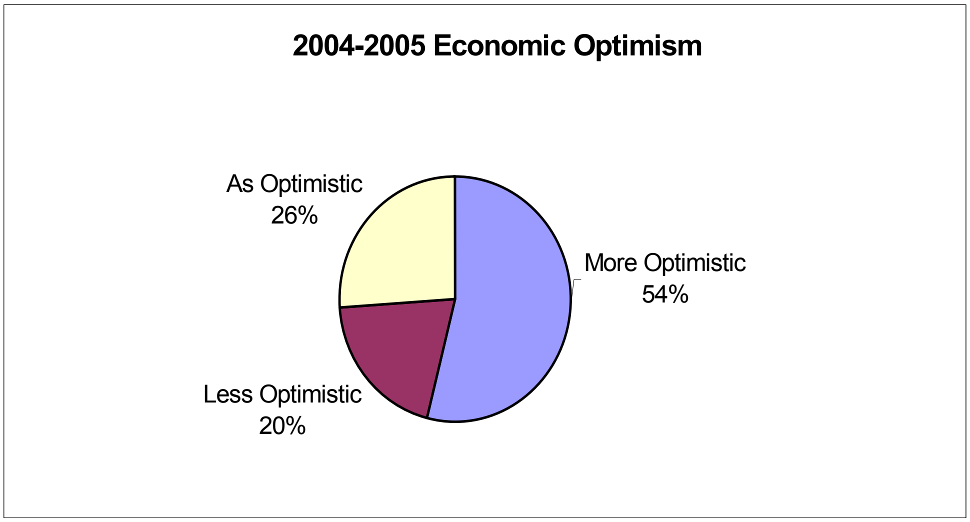
The costs of publicly funded construction projects are becoming an increasing concern in Sonoma County. Not only will budget restrictions impact the development of future projects, but also current projects are threatened by inflated costs and high project expenditure estimates.

Recent cases include the relocation of Kenilworth Junior High School in Petaluma, which after a second round of bidding in May 2004, found projected costs to be $5 million over budget. This increased project estimate forced district officials to revise proposals. In addition, the projected expenditure for the development of the Green Music Center at Sonoma State University in May 2004 came in 33% higher ($9 million) than original estimates, which caused construction to be delayed.[5]

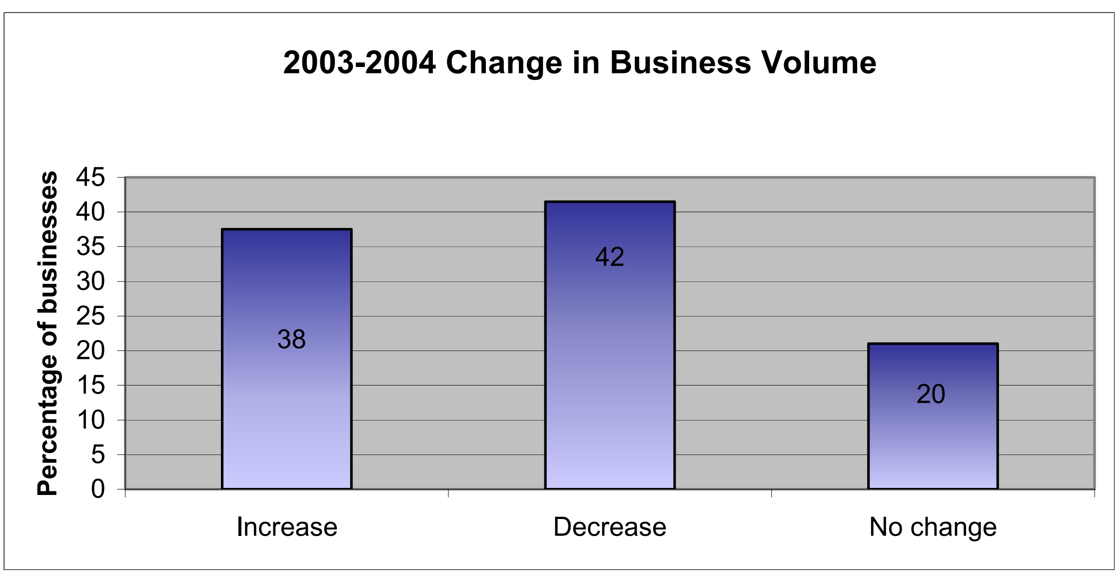
Increasing industry costs can be partly attributed to the global construction boom. Prices on basic materials such as wood, steel, and cement have been rising rapidly. The *North Bay Business Journal* reports, "Increases in materials prices, insurance premiums, and fees have added as much as a third to the cost of new construction and tenant-improvement projects in the North Bay." [6] Additionally, the *Journal* reports that, "In the past 18 months, macroeconomic forces ranging from an industrial ramp-up in China, reconstruction in Iraq, and hurricane recovery in Florida have sent the price of structural steel, lumber, plywood, sheet metal, copper pipe, concrete, wiring, and fuel skyrocketing from week to week."[7]

Industry Indicators

Construction firms were generally positive in their outlook towards the economic climate for 2004-05. Only 42 out of the 230 responding companies believed that the economy would be worse in 2004-05 than it was in 2003, while 80% of respondents were at least as optimistic or more optimistic about the economy as they were the previous year.

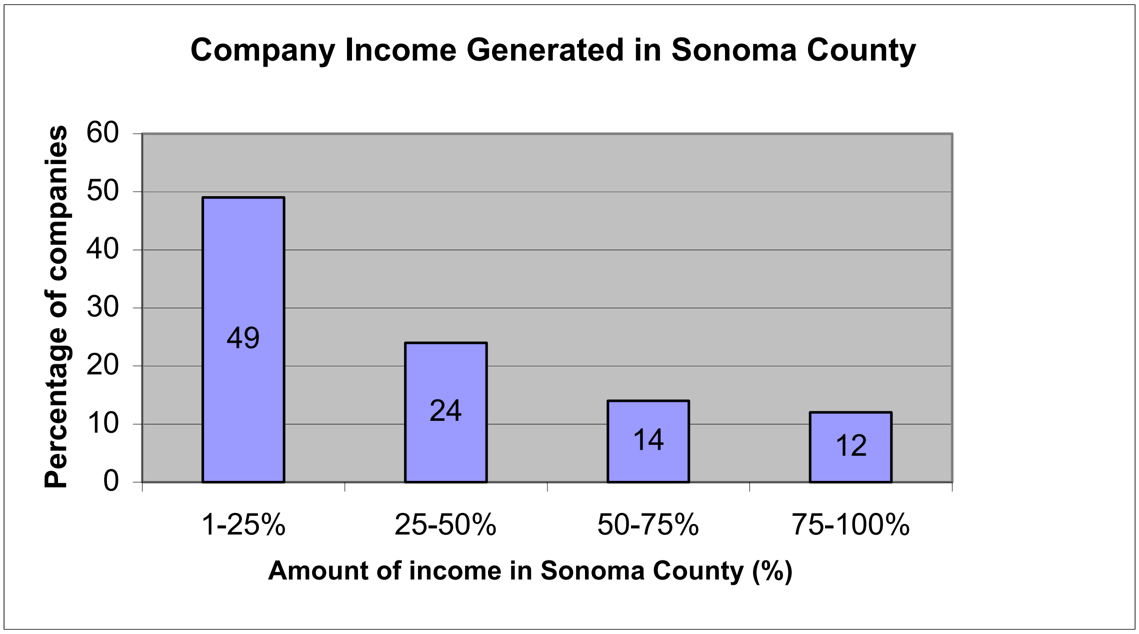


Although many respondents are optimistic about current conditions, 42% of responding firms reported that business has decreased over the past year. Top economic challenges reported in this survey include workers' compensation premiums, tax burdens, and high cost of living in Sonoma County. Additionally, companies experiencing an increase in business over the past year reported expansion of construction services to other counties, as well as branching out into new fields of business, as two driving forces.

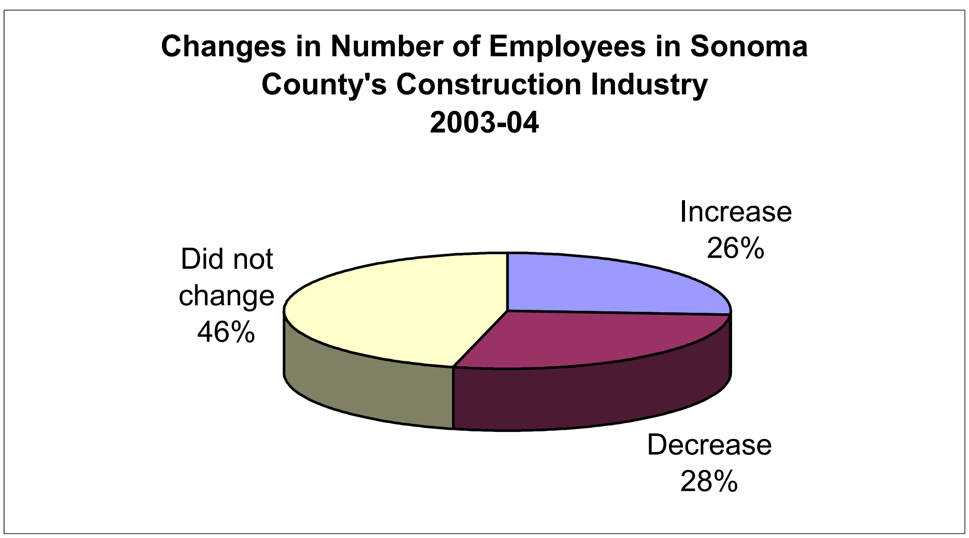


Migration

Many construction companies reported recent expansion of some of their operations to outside of Sonoma County. Only 12% of respondents reported that they conducted all or almost all of their operations inside Sonoma County during the past year. Forty-nine percent of respondents earned less than a quarter of their income from construction projects located in Sonoma County. For example, companies such as Christopherson Homes, Rivendale Homes, Schellinger Homes, and Cobblestone Homes have all expanded their operations to areas outside of Sonoma County. Moreover, projects and developments in areas such as Sacramento have influenced local banks such as Exchange Bank, Sonoma National Bank and North Coast Bank to make loans in other counties.



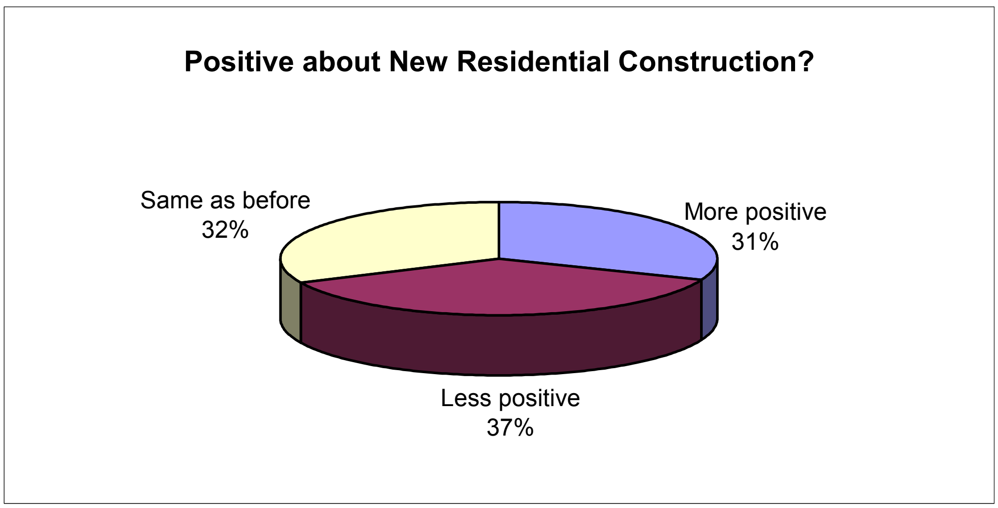
The number of employees working in the construction sector has remained stable over the past year. Forty-six percent of respondents reported that their numbers of employees remained constant, while 26% reported an increase in employees.

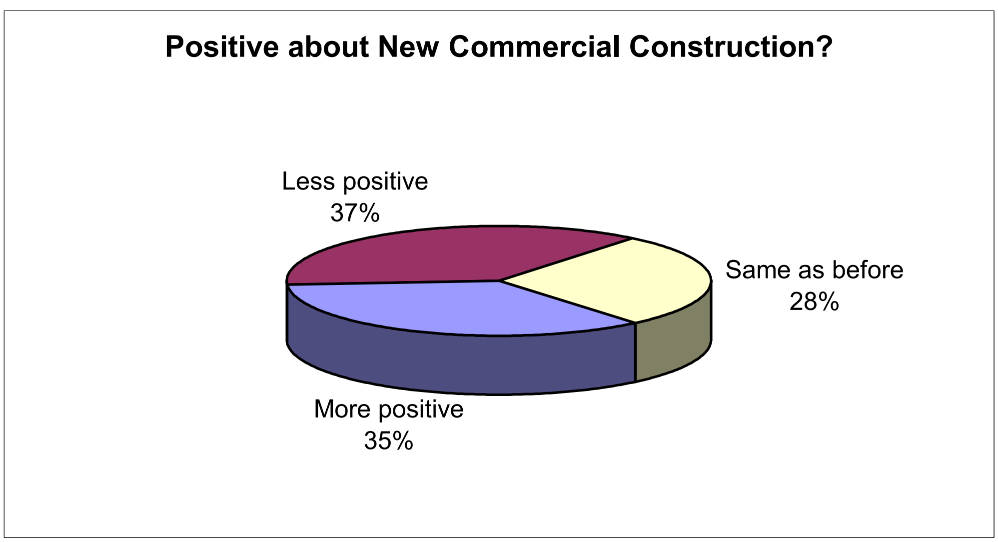


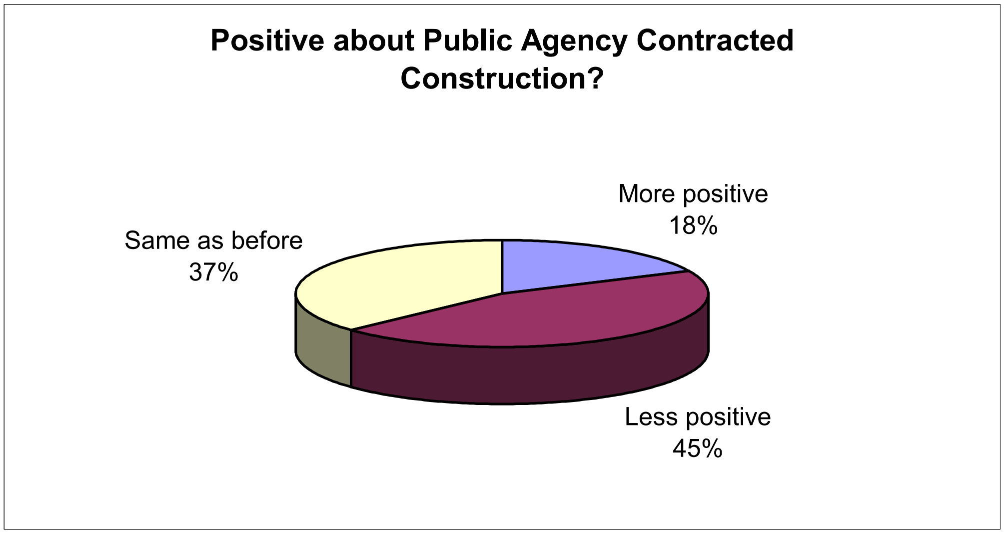
According to the California's Employment Development Department's (EDD) October 2004 employment statistics, Sonoma County employs an estimated 13,400 people in the construction sector, approximately 7% of the County's workforce.[8] To remain competitive in the 21st century, the construction sector should work towards remaining innovative in order to stay competitive. Collaborative efforts among construction sector leaders, educators, government agencies, and other interested parties bring new ideas to the table, thus represent a way to innovatively address long-term workforce development needs.

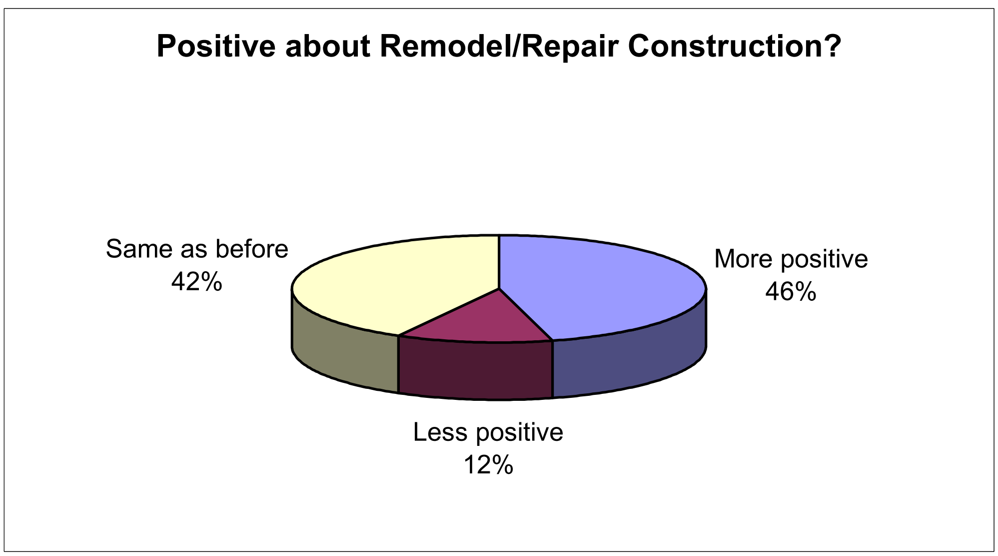
Industry Outlook

The following four charts reflect survey respondents' 2004-2005 industry outlook. They were able to forecast their degree of optimism for new residential construction, new commercial construction, public agency-contracted construction and remodel/repair construction.





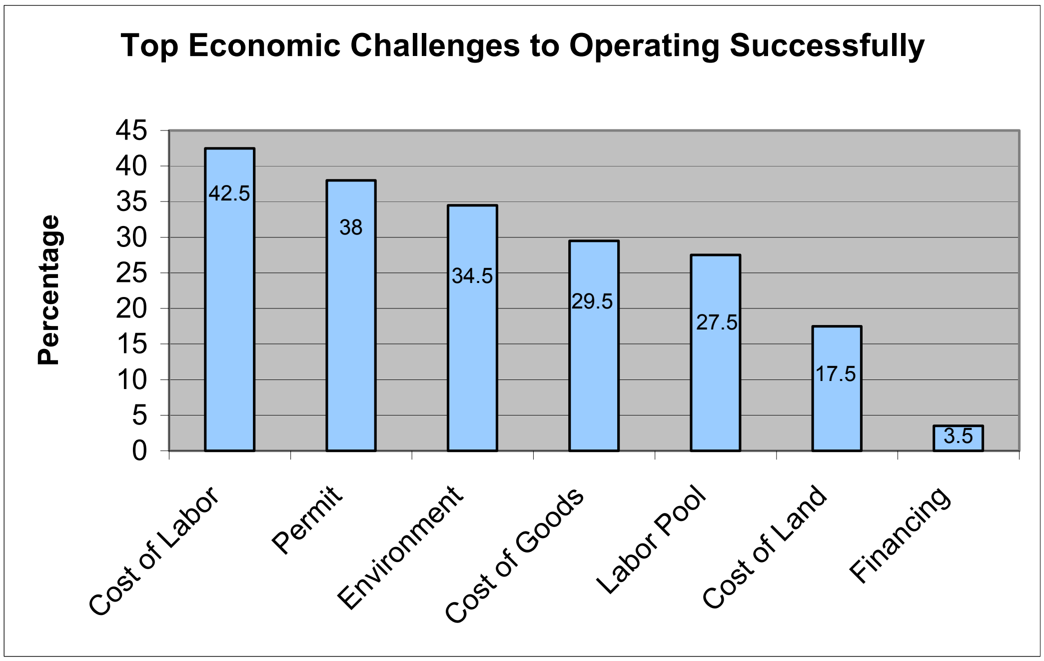




Respondents were most positive about the 2004-2005 prospects for remodeling and repair construction projects. Low interest rates over the past few years and the widespread availability of home equity loans were likely factors in that positive assessment. By contrast, more pessimistic views were expressed about public agency construction, with 45% reporting less positive about the 2004 outlook. Those views can be attributed in part to statewide budget cuts that limited the funding potential for public projects in Sonoma County.

Challenges

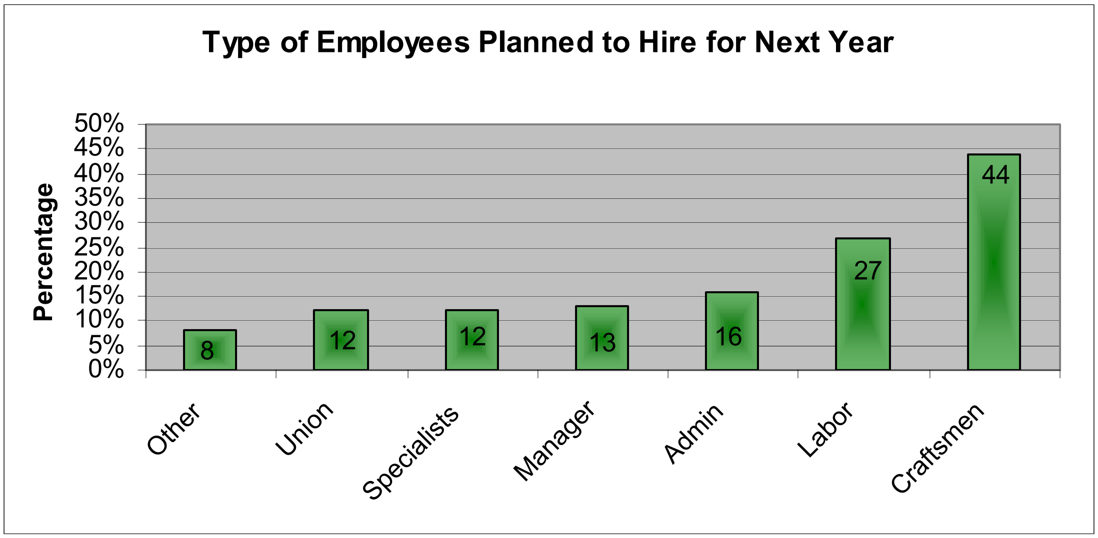
Companies were asked to report their top three challenges to operating successfully in Sonoma County. The following chart displays that cost of labor was the most challenging issue (42.5%), closely followed by the local permitting process (38%), and environmental issues (34%). Challenges reported less problematic by respondents include financing (3.5%), and the cost of land (17.5%).



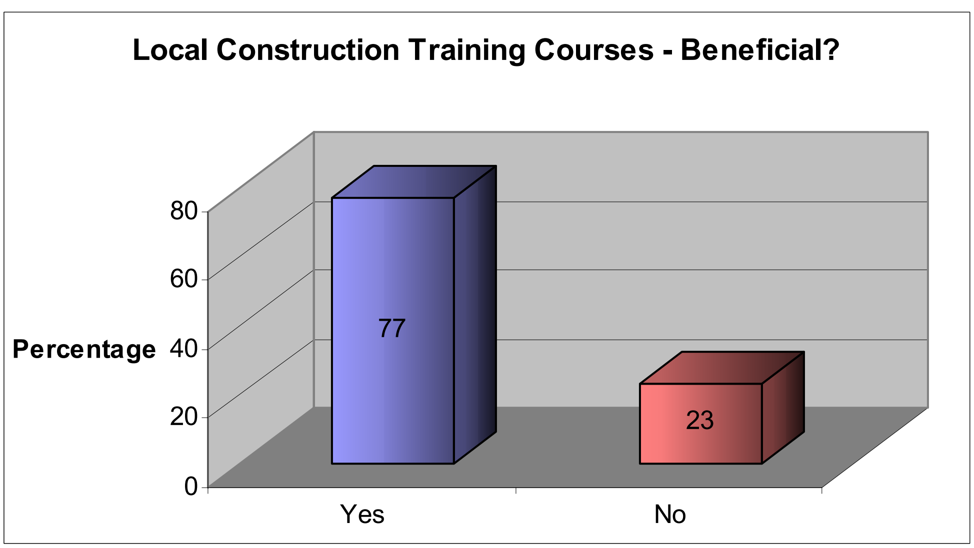
The confluence of multiple factors, however, including the difficulty in finding skilled and experienced workers, high cost of living, and soaring costs of construction material pose the greatest challenges to the local construction sector.

Labor

The following chart highlights the type of employees the local construction companies plan to hire in the following year. Forty-four percent of respondents reported increasing the number of craftsmen, and 27% reported hiring more laborers.

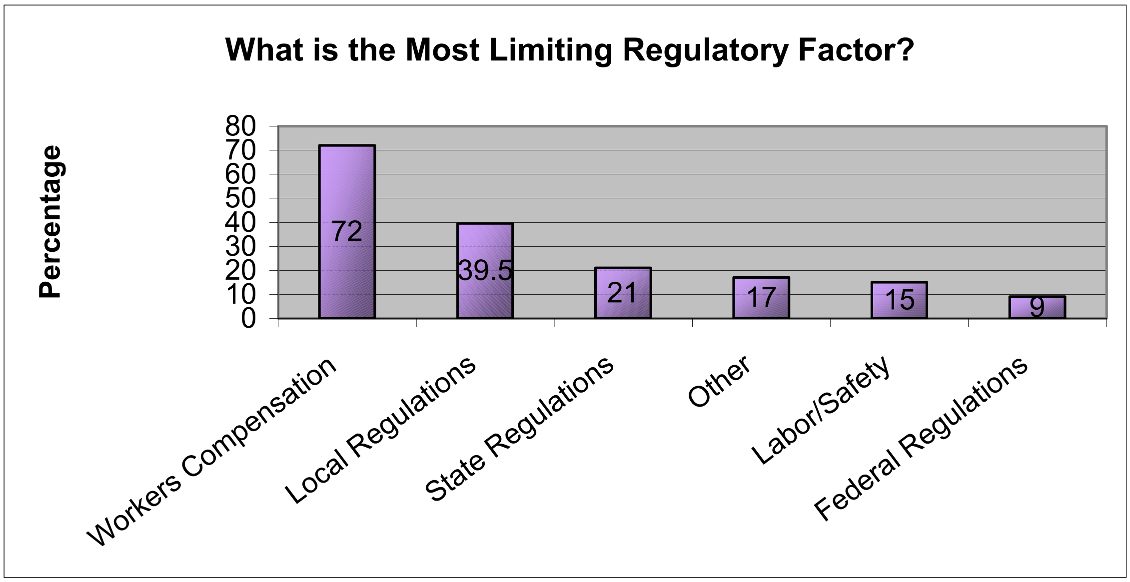


Companies were asked to state whether or not they believed more courses in construction in high schools and colleges would benefit their industry. More than three quarters (77%) of respondents agreed. More training courses should help offset the rising costs of labor by cutting training and recruiting costs, and help provide the industry with a larger locally based workforce. The Sonoma County Workforce Investment Board provides excellent job training programs, which local firms can look to for training needs.



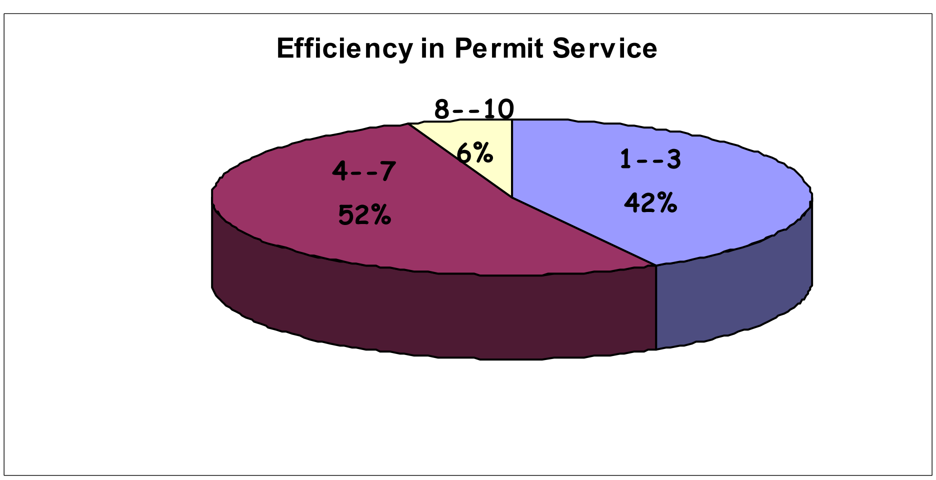
Limiting Regulatory Factors

Respondents were also asked for feedback on regulatory and other operating issues in Sonoma County. Almost two-thirds of companies listed the increasing costs of workers' compensation premiums, making it the number one challenge facing the local industry. This largely reflects the statewide problem affecting all major industries. In a recent study by UC-Davis, researchers discovered that California construction companies were paying $40 in workers' compensation insurance expenses for every $100 in a carpenter's wages.[9]



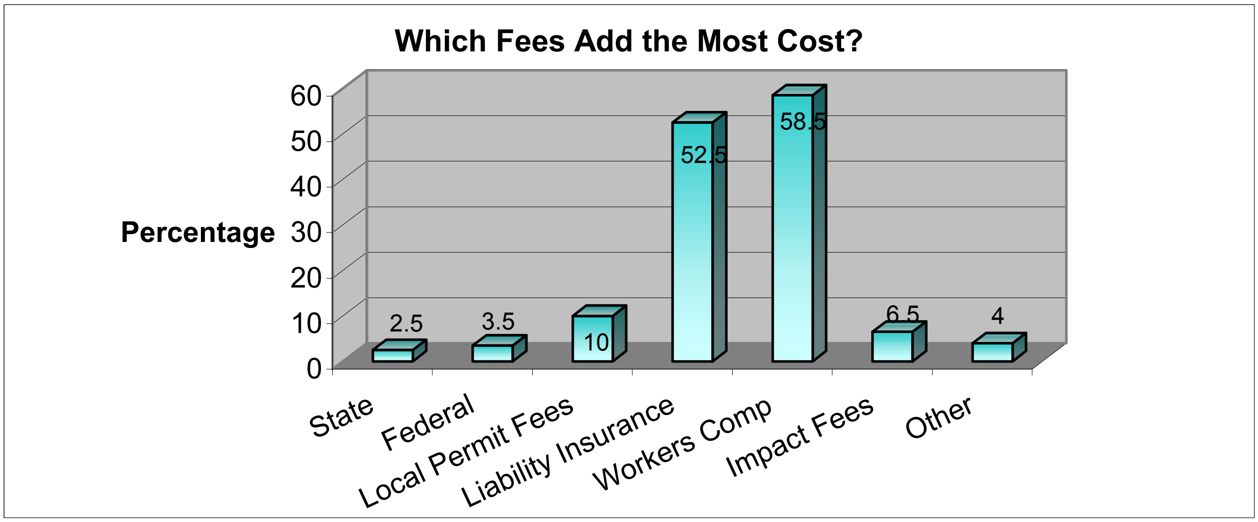
Efficiency in Regulatory Agencies' Service

Perceptions about the local development review process were also largely negative. The following graph shows the distribution of responses regarding the perceived efficiency of local regulatory agencies on a scale of 1 (very bad) to 10 (excellent). Only 6% rated the current system as "good" or "excellent," with 42% of responding firms stating that the service provided was "poor" or "very bad".



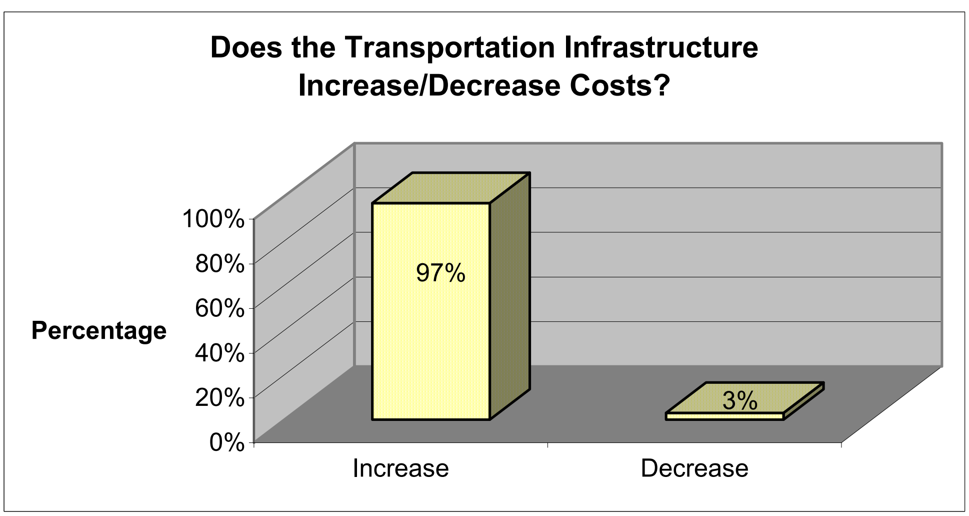
Costs of Operation

When asked what fees were the most damaging to the construction industry, liability insurance and workers' compensation premiums were viewed as the two major factors. With those costs at 2.5 times the national average, several firms reported that they are actively looking to move operations out of state.[10]



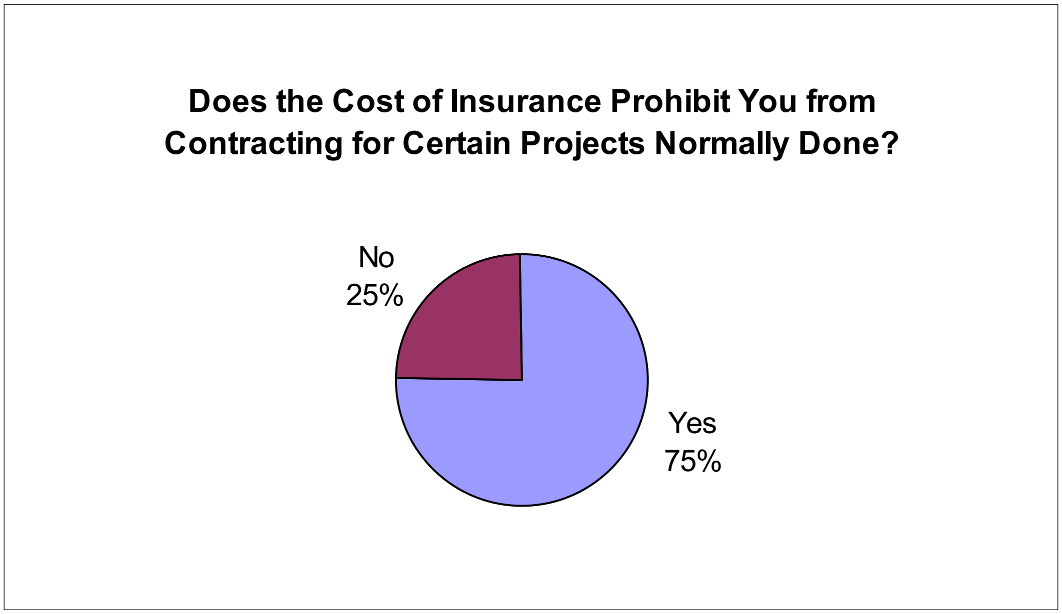
Transportation Infrastructure

Ninety-seven percent of survey respondents reported that poor transportation infrastructure in Sonoma County increased project costs. Many firms reported heavy reliance on Highway 101 in the majority of Sonoma County cities as a main source of delay.



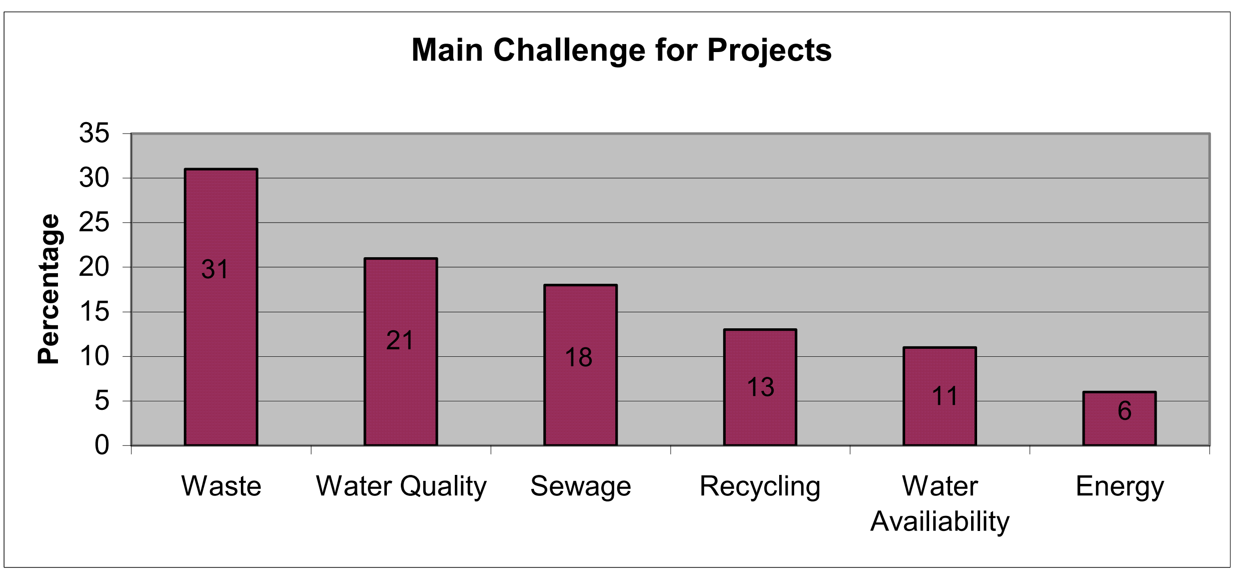
Insurance

For many construction companies, the cost of insuring a project is one of the most important factors in the bidding process. Three-quarters of companies surveyed found that they were shelving prospective projects due to the costs of insuring against risks, liability, and other potential areas of legal responsibility.



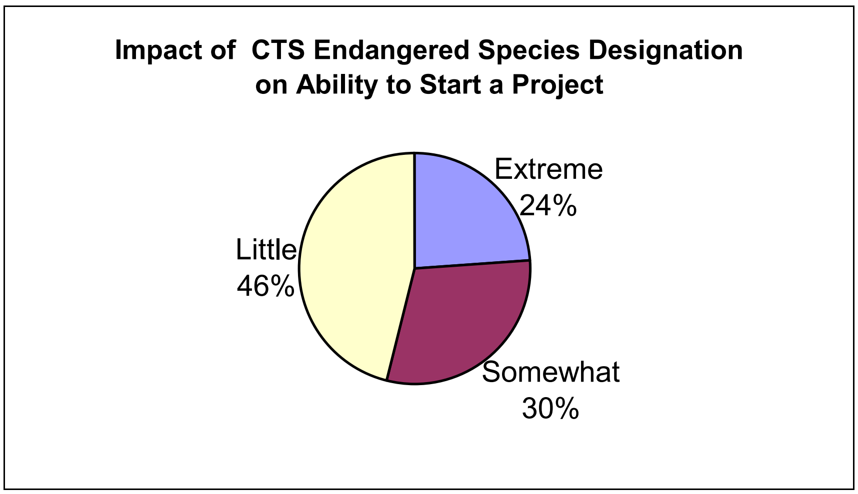
Environmental Regulation

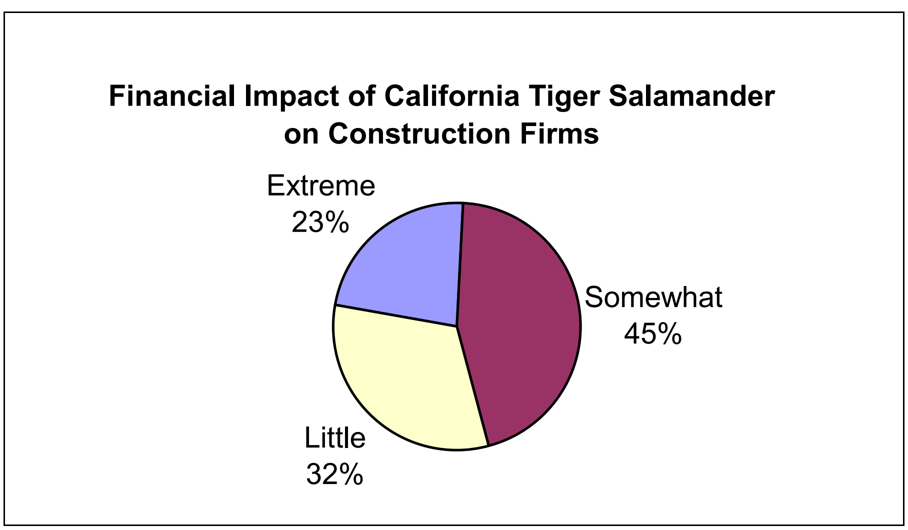
Respondents were asked about their views on environmental regulation, and what, if any, challenges they faced. Survey respondents viewed waste disposal as the most problematic issue. Energy availability was rated the least challenging issue.



California Tiger Salamander

In July 2004, the U.S. Fish and Wildlife Service listed the California Tiger Salamander as a "threatened" species, which means that developers in Sonoma County must now take their habitats into account when planning projects. Fifty-four percent of respondents believed that the California Tiger Salamander's listing harms their ability to start construction projects in Sonoma County. A local taskforce is formulating guidelines for establishing mitigation banks in the county.[11] The taskforce's work will have important implications for the local construction industry.





Conclusion

Sonoma County construction sector conditions are mixed. Both positive and negative industry indicators demand local attention from firms, stakeholders, and other interested parties. On the positive side, workers' compensation insurance reform and strong consumer demand for new building projects are factors improving the outlook of the local construction sector. On the other hand, rising material expenses, high insurance premiums, dissatisfaction with the local agencies permitting process, and shortage of a local skilled workforce are factors presenting serious challenges to local construction companies.

The opportunities identified in the beginning of this report represent several steps toward addressing many of the challenges facing local construction firms. The ongoing construction industry forum, for example, would provide companies with a venue for exchanging ideas and sharing information to work together on common industry challenges. In addition, it would serve as a central point of communication with local government agencies to address some of the criticism mentioned in the survey results.

Considerable progress has been made within the construction sector and educational institutions/services, and continued collaboration will strengthen future training and internship programs. A key priority for this region is to ensure that, if possible, residents of Sonoma County fill job opportunities at local firms.

Other opportunities include increasing online permitting, producing an electronic newsletter, a construction industry database similar to that of the National Institute of Construction Management & Research in India, and presenting industry awards for best practices in the construction industry similar to the NOVA awards in Michigan presented by the Construction Innovation Forum. Moreover, because service issues are important, producing a future study that surveys both the consumer/industry and the permitting/planning agencies' perspective may provide a more in depth analysis of the local sectors needs, as well as insight into mitigating future challenges.

Finding new ways to innovate in local industries is the key to successful and sustainable economic development. Therefore, it is hoped that the opportunities identified in this report make the case for new partnerships among companies, educators, and local government agencies to work together to help ensure the success of Sonoma County's construction sector.

Methodology

The Economic Development Board (EDB) conducted the 2004 Sonoma County Construction Survey to obtain a general "snapshot" of the Sonoma County construction industry. Surveys were mailed to 987 local companies and 230 responded. This yielded a strong response rate of 23%. From these responses, it was possible to discern general trends within the industry. This report outlines these trends and suggests opportunities in addressing some of the challenges facing local construction companies.

Please note that all data contained in this report is based on information self-reported by survey respondents, which was not factually verified by the EDB. The responses were then gathered into a database for analysis. Due to the fact that survey respondents may provide no responses to some questions, the category percentages indicated in the graphs for those questions may not come to 100%. Where replies are mutually exclusive, percentages may be slightly off due to rounding. Where replies are not mutually exclusive, percentages may total more than 100%.

We intended to obtain averages that provide a general "snapshot" of the construction industry in Sonoma County. Accordingly, the averages have not been weighted by any factor or interest. The data presented is as accurate as the polling technology permits. A response rate of 23% is high for a written survey, and all known construction companies were included in the mailing, in order to measure the major economic activity engendered by this sector accurately. Lists were obtained from the North Coast Builders Exchange, Home Builders Association of Northern California, the Engineering Contractors' Association, and others.

Acknowledgements

This report could not have been written without the assistance of the construction industry. Without the encouraging response to the written survey, this report would not have been possible.

The EDB Board Members--notably Steve Herron, Dirk Leger, and Pam Chanter--were extremely supportive and offered excellent advice. Melissa Maskell, a volunteer who is a student at the Santa Rosa Junior College helped tabulate the results. Rachel Blank offered significant assistance with the production of the graphs and charts. Joe Horak, Dee Stewart and Nicole Knecht, edited, revised, and offered numerous helpful suggestions, ensuring the report's accuracy and authenticity. Stefanie Lustenburger and Adam Grosch both worked on early drafts of the survey, and Nicole Knecht revised and completed the final report.

A special thanks go to the following people who lent their name to the survey and report, and helped in reviewing its content: Charles Carson, Home Builders Association of Northern California; Keith Woods, North Coast Builders Exchange; Tallia Hart, Engineering Contractors Association; Guenter Meiburg, American Subcontractors Association; Myles Davis, International Engineering Consortium; Bill Hanna, Association of General Contractors; Anisa M. Thomsen, National Electrical Contractors Association; Dan Digardi, Carpenters Union Local 751; Pete Parkinson, Sonoma County Permit and Resource Management Department; Paul Eelkema, Sonoma County Office of Education; Al Redwine and Jerry Dunn, the Sonoma County Workforce Development Board; Willie McDevitt, McDevitt & McDevitt Construction Corp.; Joe Richardson, Carpenters Training Committee; Frank Cuneo, Sheet Metal Workers Apprenticeship/North Bay Apprenticeship Coordinators Association; William J. Campbell, Redwood Empire Electrical JATC, Training Director; and Steven A. Benjamin; North Bay Labor Council.

Finally, thanks to Oliver Newham for conducting the survey and producing the bulk of this report. Mr. Newham is from the UK, and spent a year as a Project Coordinator with the EDB thanks to the generous support of the Henry Samman Foundation of Hull, England.

Ben Stone

Executive Director
November 2004

Endnotes

[1] Simonson, Ken. "Quick Facts about the Construction Industry." The Association General Contractors of America. June 8, 2004. Internet access:http://www.agcga.org/content/public/Overview/quick%20facts.doc
[2] The California Department of Finance website. Internet access: www.dof.ca.gov
[3] San Jose Business Journal article "Only Small Increase Seen for California Construction" April 2nd, 2003.
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[6] Quackenbush, Jeff. "Building Costs Surge as Material Prices Jump" Special Report: Construction Update in The North Bay Business Journal. November 1, 2004, pages 9, 16.
[7] *Ibid*
[8] California Employment Development Department. Labor market Information/Employment by Industry in Sonoma County. Internet access on 11/15/04: http://www.labormarketinfo.edd.ca.gov/cgi/databrowsing/localAreaProfileQSMoreResult.asp?viewAll=yes&viewAllUS=&currentPage=&currentPageUS=&sortUp=&sortDown=&criteria=Current+Employment+Statistics+%28CES%29&categoryType=employment&geogArea=0604000097&timeseries=&more=More&menuChoice=localAreaPro&printerFriendly=&BackHistory=-1&goTOPageText=
[9] Wheeler, Noel. "An issue paper for the California Construction Contractors" Internet access: http://www.clp.com
[10] Sen. Chuck Poochigian
[11] North Bay Business Journal 08/02/04

2004 Construction Industry Survey

Name of Participant:	Title:	Company:
Address:	Phone/Fax:	E-mail:
Headquarter location:		First year of operation:

1. What field of construction is your firm engaged in? (Please check all that apply)
❑ Commercial ❑ Residential ❑ Sub ❑ Remodeling ❑ Engineering
❑ Architecture ❑Other ________________________

2. Percentage of your work (income) that is performed for public agencies: _____________

3. Compared to 2003, are you ***more/less/as*** optimistic about the economy for 2004-2005? (Please circle one)

4. Did your business volume ***increase/decrease/not change*** in Sonoma County last year? (Please circle one)

5. What percentage of your income do you generate outside Sonoma County? ____________

6. Did your number of employees ***increase/decrease/not change*** overall last year?

7. Are you ***more/less/as*** positive about new residential construction for 2004-2005?

8. Are you ***more/less/as*** positive about new commercial construction for 2004-2005?

9. Are you ***more/less/as*** positive about public agency-contracted construction for 2004-2005?

10. Are you ***more/less/as*** positive about remodel/repair construction for 2004-2005?

11. Top economic challenges to operating successfully in Sonoma County: (Check up to three)
❑ Cost of Goods ❑ Cost of skilled labor ❑ Cost of manual labor
❑ Availability/cost of land ❑ Available financing ❑ Local permit processes
❑ Labor pool ❑ Environmental issues ❑ Cost of mitigation fees
❑ State and federal regulations ❑ Other ____________________________

12. Type of employees you plan to hire next year: (Check all that apply)
❑ Management ❑ Administrative ❑ Specialists ❑ Laborers
❑ Skilled craftsman ❑ Union ❑Other ______________________

13. Most difficult classifications of employee to recruit: ___________________________
Why? ____

14. Would the local construction trade ***benefit/not benefit*** from more local training courses on construction (e.g. high school, pre-apprenticeship)? Yes ______ No ______

15. What is the most limiting regulatory factor from operating in Sonoma County: (Check two)
❑ Labor/Safety ❑ Workers comp. ❑ State regulations
❑ Federal regulations ❑ Local regulations ❑ Other
____

16. How is the efficiency in service provided by regulatory agencies? (1=Very bad, 10=Excellent)
1 2 3 4 5 6 7 8 9 10

17. Are there agencies that are commendable in their efficiency? If so, please note:
____
____

18. What is in your opinion the main reason for a lack in efficiency? (Check all that apply)
❑ Poor processes ❑ Not enough staff ❑ Lack in customer care
❑ Lack of training/knowledge ❑ Other _________________________

20. Which fees add the most cost to your operation in Sonoma County: (Check one)
❑ State ❑ Local permit fees ❑ Workers compensation
❑ Impact fees ❑ Federal ❑ Liability insurance ❑ Other

21. Does the transportation infrastructure in Sonoma County ***increase/decrease*** project schedules?

22. Does the transportation infrastructure in Sonoma County ***increase/decrease*** costs?

23. Does the current cost of insurance/liability prohibit you from contracting for certain projects you have done before? (e.g. condos, townhouses, apartments) ❑ No ❑ Yes
Type of projects____

24. What is the main challenge for your projects regarding water, waste, and energy? (Check two)
❑ Water quality regulation ❑ Water availability ❑ Energy availability
❑ Sewage disposal requirements ❑ Waste disposal/hazard ❑ Recycling
❑ Other______________________________

25. What is your largest concern with financial capital access in Sonoma County?
(Check one) ❑ Cost ❑ Terms ❑ Attractiveness
❑ Growth ❑Debt/equity ratio ❑ Other _____________________________

26. What is your top concern if you are planning to sell your business? (Check one)
❑ Exit strategy ❑ Finding buyer ❑ Determining value ❑ Other options
❑ Timing the sale ❑ Don't own ❑ Not selling ❑ Other___________

27. To what degree has the listing of the California Tiger Salamander impacted your ability to begin construction on property designated for development?

❑ Extremely Impacted ❑ Somewhat Impacted ❑ Little or no impact

28. If the California Tiger Salamander continues to limit development of private property through the next two construction seasons (2004 & 2005), what kind of a financial impact will it have on your firm? ❑ Extreme Impact ❑ Somewhat of an Impact ❑ Little or no impact