

Steady On: 2019 Cost & Building Trends in the Pacific Northwest

An Industry Report



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PICTURED: The Spheres

INTRODUCTION



Scott Redman
Sellen CEO

We know that forecasting costs in the industry is an imperfect science (and for some here at Sellen, you might even call it an imperfect art). But whatever you call it, at Sellen pulling together our annual industry report is a team effort, and we have pooled the knowledge of our preconstruction team leaders to bring you this year's market and cost trends and predictions for the Pacific Northwest A/E/C industry for the remainder of 2019.

Throughout this report, our experts take a closer look at the top market trends we're seeing in the industry right now, including sustainability trends. We've also highlighted some of the key factors that we forecast will drive costs throughout the rest of 2019 and beyond.

But before we get to that, I wanted to take a moment to zoom out and offer our overarching prediction for the remainder of 2019. For this, we only need two words: **steady on**. Everyone you ask these days is moving at a rate of "busy," and we predict that same rate of "busy" will carry us through to the next decade.

This has certainly held true for the first quarter of 2019, which has only served to further corroborate our predictions and trending analysis herein. We're seeing a lot of potential development activity in the area right now that suggests construction in 2021, 2022 and beyond could be extremely busy again.

It also proves that Seattle remains highly attractive to potential investors and developers and will continue to have a lot of job growth – especially on the Eastside. The City of Bellevue is still in the process of rezoning, but it is moving in the right direction and drawing a lot of developer interest.

As we enter the second quarter of 2019, we hope our view on today's industry trends will give you a fresh, informed perspective on what you can expect over the next year and beyond.

Best,



Scott

1. EXECUTIVE SUMMARY

We don't foresee a future slowdown in the A/E/C industry in the Pacific Northwest this year; but on the same token, it's likely the industry won't speed up — yet.

This year, Sellen is bringing you more than just the future trends for labor, materials pricing and escalation. We are digging deeper into the many and complex levels of cost analysis that are harder to quantify and fairly unpredictable, but without them, you don't have the full market picture. In doing so, we're bringing you a complete primer on cost and building trends in our industry right now.

Overall we don't foresee a future slowdown in the A/E/C industry in the Pacific Northwest this year; but on the same token, it's likely the industry won't speed up — yet. Here are the primary cost drivers and market trends that have led us to this conclusion, all of which we dig into in more detail throughout this piece.

MARKET & BUILDING TRENDS

In this section, we've highlighted seven overarching themes that we've been tracking over the last year and through the first quarter of 2019. While some of these may not be a surprise, they all hold far-reaching effects for Northwest developers. These include: 1) overall market exhaustion; 2) the effects of national interest rates; 3) Seattle's role as a "gateway city"; 4) the effect of tech companies using their workplaces to retain and recruit talent; 5) the phenomenal Eastside growth we've been seeing; 6) labor cost increases; and 7) macro-economic factors.

PRIMARY COST DRIVERS

Next, we dig a little deeper into the five main factors that drive costs. The five main factors are: 1) input costs, the basic materials and subcontractor costs we see each year; 2) the construction market, a true analysis of price versus cost when you factor in available market resources; 3) the building market, which refers to owner and occupant workplace expectations; 4) the government, and for Washington state that means a focus on changes in building codes; and 5) macro-economic factors, where we dig in deeper on items such as tariffs and divestments.

ESCALATION PREDICTIONS

This section presents all the information you generally receive from Sellen. This includes our predictions for materials cost escalation, subcontractor and labor costing trends, and overall escalation.

SUSTAINABILITY TRENDS

We didn't want to leave you without an update on what we've been seeing trending in the Northwest industry when it comes to sustainability. This includes an update on LEED version 4 and our take on the newly published version 4.1. We've also included an in-depth discussion on the importance of materials disclosure and its effects on and progress within the market. Lastly, we can't ignore the recent and upcoming changes to the Seattle and Washington state energy codes, as we believe energy codes are one of the biggest cost drivers for buildings right now.

Even when we give ourselves a chance to dig deeper into these discussions, we realize we're still only scratching the surface for some of these complex issues. We'd welcome the chance to continue the discussion — contact us!



2. MARKET & BUILDING TRENDS

Market exhaustion is an overarching theme for the Northwest's private development sector right now.

Before we dig into the details of the building market or subcontractor pricing, we're going to start out on a lighter, more digestible note: building and market trends in the Pacific Northwest A/E/C industry. Here's what we've been tracking across the Northwest over 2018 and 2019's first quarter that we anticipate will largely affect building costs and trends for the rest of 2019 and beyond.

MARKET EXHAUSTION

Market exhaustion is an overarching theme for the Northwest's private development sector right now. Many of the other trends we've tracked and listed below both contribute to and are a direct result of market exhaustion. The simple rules of supply and demand apply to the local construction market and the amount of available resources to respond to projects in the pipeline. This is one of the major factors driving the cost of construction in our local market.

INTEREST RATE EFFECTS

The Federal Reserve recently signaled that interest rates are "near neutral," whereas just recently they were a "long way from neutral." Seattle generally has low rates of return – as many private developers know, we are a city of first-tier costs but second-tier recovery rates. With low cap rates across the board already, the low rates of return and rental rate appreciation contrast with continuing cost appreciation make private development even more of a challenge, and – in some cases – even stalls projects. That said, the Federal Reserve has signaled that they may be tempering the relatively aggressive interest rate rises that occurred through 2018 and will remain hopefully flat through 2019.

FIGURE 2.1: 10-Year Treasury Constant Interest Maturity Rate

Source: Board of Governors of the Federal Reserve System



SEATTLE IS A “GATEWAY CITY”

Seattle continues to garner interest from atypical investment sources, primarily foreign and out-of-state investments. While the interest has been somewhat tempered by Seattle’s relatively low real estate returns, it’s still enough to transition Seattle to a first-tier city in terms of real estate investment capital. Boosting this is Seattle’s relatively high construction costs with relatively low rental rates in contrast to some other first-tier markets, such as San Francisco, New York and Los Angeles.

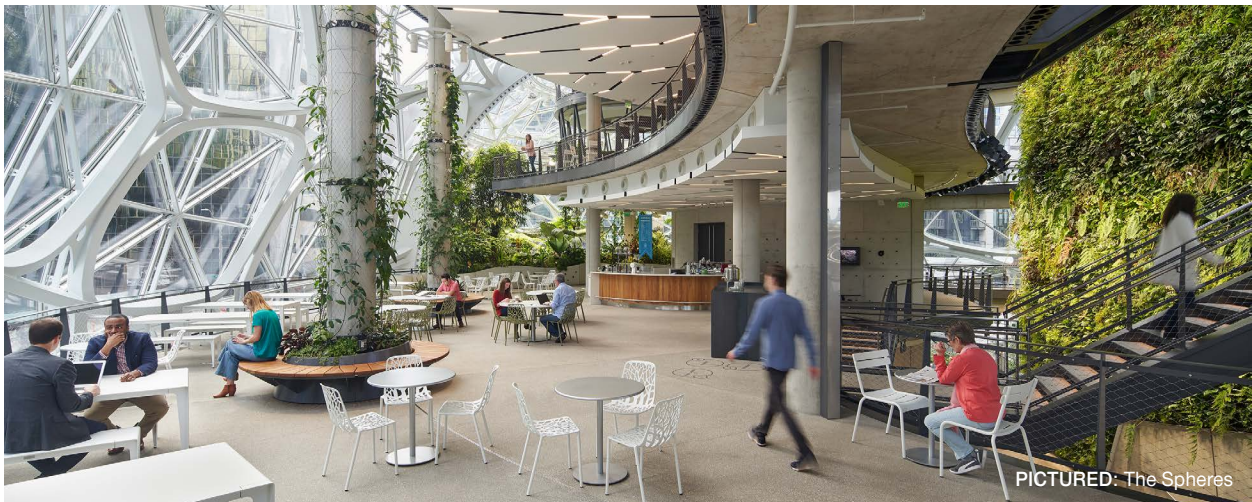
In the race for talent recruitment and retention, and design aesthetics and office features are playing a larger role than ever before as firms use them to differentiate themselves.

TECH “OFFICE RACE”

With Amazon and Microsoft leading the tech charge in the Northwest, more and more similar tech firms are opening offices in our area, and within those offices are what we affectionately refer to as the tech “office race.” In the race for talent recruitment and retention, and design aesthetics and office features are playing a larger role than ever before as firms use them to differentiate themselves.

However, this office race is changing the building market – specifically for spec owners as they try to market to tech tenants. It’s hard to predict what an owner might want, and many spec buildings have required renovations after a tenant is secured. With buildings becoming more unique and sophisticated, they become less economically viable and are a higher risk for private developers.

Regardless of what Amazon chooses to do regarding its second headquarters, locally there are still a lot of Bay Area clients in particular that are focusing their energy on future Eastside developments. Between these new players and the local incumbents, there’s just a lot of activity, particularly in Bellevue, Redmond and Kirkland.



EASTSIDE GROWTH

Over the past year, the amount of growth that the Eastside has seen is bordering on the absurd (and we mean that in a good way). With the recent rezoning of Bellevue, multiple large, transit-oriented developments are in the works. Additionally, the Eastside tech market is experiencing a resurgence with major players such as Google and Facebook moving into Kirkland and Redmond, respectively, as well as the major modernization planned for Microsoft's campus.

LABOR COST INCREASES

It's no secret that labor costs are increasing. Unions are re-negotiating across the board, but we are in a very different marketplace than even just a few years ago. The cost of living in the Northwest remains high, as does the expectations for higher wages.

MACRO-ECONOMIC FACTORS

Global macro-economic factors are proving to be increasingly hard to predict, and they have the ability to completely railroad every other cost variable and trend. These include potential tariffs, currencies, some Chinese divestments, and continued Canadian investments, to name a few. The primary thing we can do is remain vigilant in tracking these factors and their potential effects on the Northwest's real estate market.



3. PRIMARY COST DRIVERS

The next levels of cost analysis are harder to quantify and can be fairly unpredictable, but without them, you don't have the full market picture.

Each year, Sellen has provided you with future labor trends, materials pricing and escalation. By doing that, however, we're only scratching the surface of all the cost driving variables that factor into the forecasting equation. The next levels of cost analysis are harder to quantify and can be fairly unpredictable, but without them, you don't have the full market picture. While it's a tall order to break down each layer and make it easily digestible, this year we wanted to try. Here's our best shot at a primer on what we consider the five primary variables that have and will continue to drive costs in 2019.

1: INPUT COSTS

Input costs are what you'll find in most industry forecasts: materials pricing, subcontractor trends and labor negotiations. In 2018, we saw labor costs rise dramatically in key union trades, and that trend will continue with the trades up for negotiation in 2019. While copper, lumber and diesel fuel prices may lower in 2019, the pricing of most materials will rise. Many pricing changes will depend on outside and/or macro-economic forces, such as tariffs (don't worry – we'll get to that). For our full list of predictions, [click here](#).

2: CONSTRUCTION MARKET

What do we mean by the 'construction market'? Here, we're talking about a true analysis of price versus cost, coupled with the availability of resources in a busy market. This year, labor resources will still be a challenge as subcontractors remain busy and their options numerous. As competent and available resources continue to remain scarce, the resulting increase in cost, tied primarily to decreased productivity, will continue to be a major cost driver. Of all the variables, this "market opportunity issue" is the hardest to predict and has the highest potential to affect overall building costs.

3: BUILDING MARKET

It seems like a no-brainer to state that in today's real estate industry, we don't build the same buildings that we built 15 or 20 years ago. But this reality has far-reaching cost implications in today's market. "Building market" refers to the expectations that owners and building occupants have for building performance and aesthetics. Especially in Seattle, competition for talent can be fierce, and a new, unique workspace can be a differentiator for attracting new employees. These expectation factors are highly dynamic and can dramatically affect a building's cost from year to year. Building market is the most difficult variable to quantify and requires the most vigilant attention.

We predict building codes to be one of the biggest drivers of costs this year.

4: GOVERNMENT

Now we're getting into variables that are even more out of our control, but they have a low to medium overall effect on building cost. The government includes everything from regulations and new codes to taxes and tariffs.

We predict building codes to be one of the biggest drivers of costs this year. Last year, Sellen released a white paper with the results of research we undertook with PAE Engineers and MacDonald-Miller about the 2015 Seattle Energy Code. It's been one year since the final amendments of this code were adopted, and we have been updating our research and the white paper as new information rolls in. If you're planning on building a high-rise office, residential tower or tenant improvement in Seattle in the near future, check out our [white paper](#) to learn how different mechanical systems and glazing solutions affect costs while meeting the code.

Washington State will enact the new 2018 energy code in 2020. While less aggressive than the City of Seattle, owners will feel its impact on costs. We're currently monitoring how those changes might manifest themselves. Structurally, there are changes as well: In November 2018, the Washington State Building Code Council codified additional options for using mass timber and made those changes retroactively applicable to the current 2015 State Building Code, with the changes taking effect this spring or summer. With conditions, these changes allow for additional building height and create new construction types for mass timber up to 270-foot tall, distinct from the heavy timber classification.

5: MACRO-ECONOMIC ISSUES

When we reach the final variable, we're discussing cost drivers on a global scale: expansion and recession, currencies, commodities, capital flows, etc. While all of these factors drive costs, capital flows may have the most visible and direct impact on properties in the Northwest. Major capital inflows and outflows from Asia and Canada, as well as other international locales, have been and will continue to be a unique part of the real estate landscape in the Northwest.

FIGURE 3.1: Building Cost Variables

Here, we've done our best to qualify the degrees of variability and effects on overall building cost presented by all of the aforementioned cost drivers.

CATEGORY	EASE OF QUANTIFICATION	PREDICTABILITY	DEGREE OF VARIABILITY	EFFECT ON OVERALL BUILDING COST
Input Costs	Relatively Easy	Somewhat Predictable	Low to Medium	2%-6%
Construction Market	Hard	Next to Impossible	High	(5%)-10%
Building Market	Very Hard	Somewhat Predictable	Low to High	0%-10%
Government	Somewhat Easy	Depends	Low	0%-2%
Macro-Economic Issues	Some Easy/Some Hard	Hard to Predict	Low	?

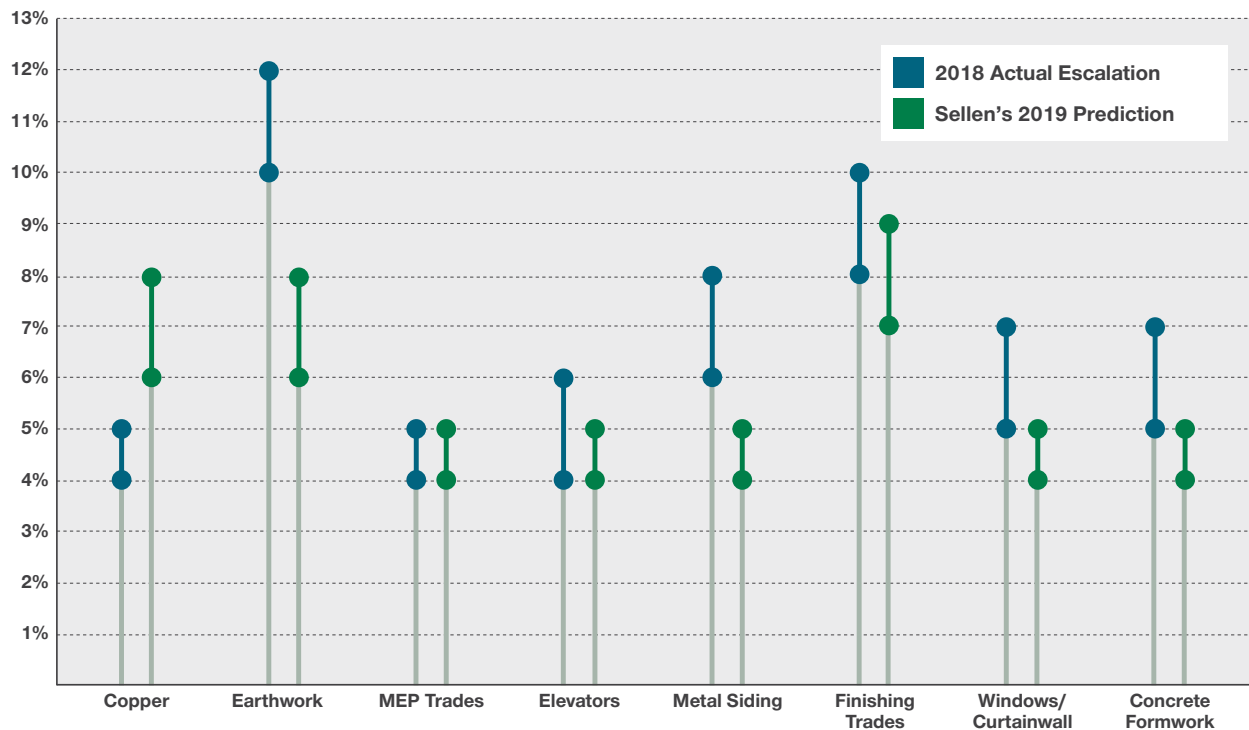
4. ESCALATION PREDICTIONS

SUBCONTRACTOR TRENDS

Subcontractors continue to remain very busy and labor resources are still a challenge for Northwest general contractors. Last year, we saw labor costs increase dramatically and they will continue to increase in 2019, primarily because of trade negotiations.

TRADE	2018 ACTUALS	2019 PREDICTIONS
Steel Erection	4%-5% ▲	6%-8% ▲
Earthwork	10%-12% ▲	6% -8% ▲
MEP Trades	4%-5% ▲	4%-5% ▲
Elevators	4%-6% ▲	4%-5% ▲
Metal Siding	6%-8% ▲	4%-5% ▲
Finishing Trades	8%-10% ▲	7%-9% ▲
Windows/Curtainwall	5%-7% ▲	4%-5% ▲
Concrete Formwork	5%-7% ▲	4%-5% ▲

FIGURE 4.1: Subcontractor Cost Escalation



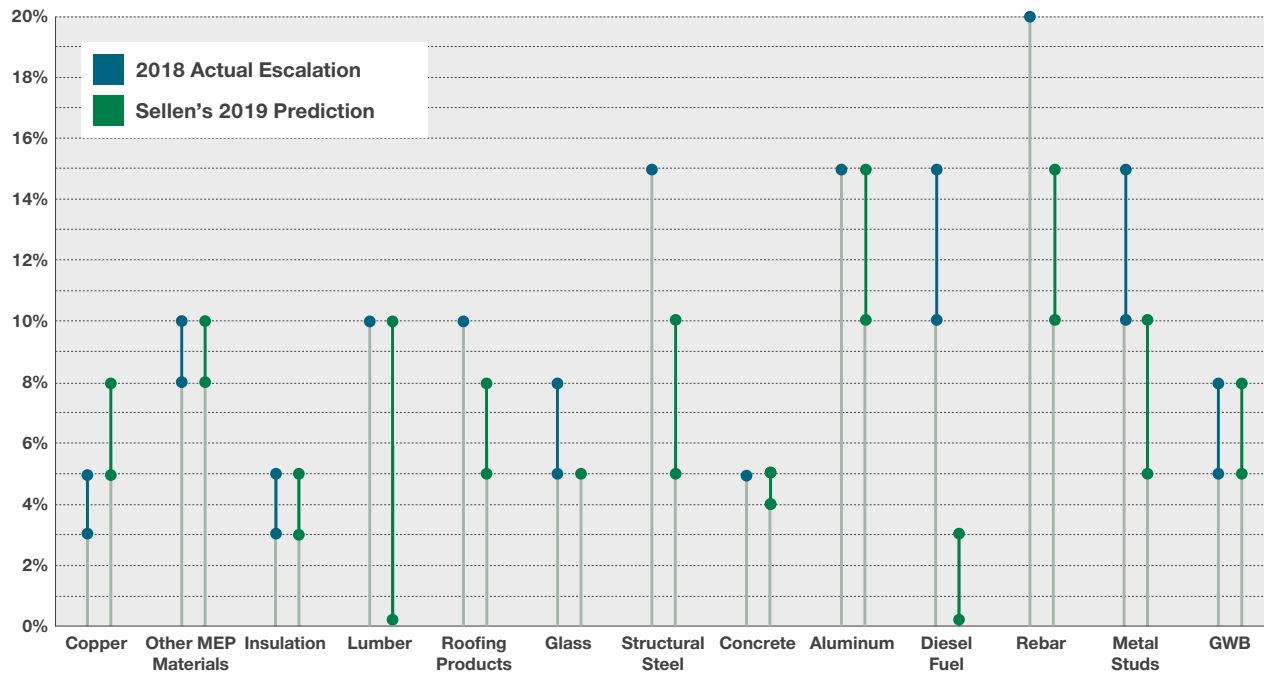
Owners can expect material costs to make up around 40 percent of overall job costs.

MATERIAL COSTS

Material costs are largely tariff dependent. Owners can expect material costs to make up around 40 percent of overall job costs.

MATERIALS	2018 ACTUALS	2019 PREDICTIONS
Copper	3% to 5% ▲	5% to 8% ▲
Other MEP Materials	8% to 10% ▲	8% to 10% ▲
Insulation	3% to 5% ▲	3% to 5% ▲
Lumber	10% ▲	0% to 10% ▲
Roofing Products	10% ▲	5% to 8% ▲
Glass	5% to 8% ▲	5% ▲
Structural Steel	15% ▲	5% to 10% ▲
Concrete	5% ▲	4%-5% ▲
Aluminum	15% ▲	10% to 15% ▲
Diesel Fuel	10% to 15% ▲	0%-3% ▲
Rebar	20% ▲	10% to 15% ▲
Metal Studs	10% to 15% ▲	5% to 10% ▲
GWB	5% to 8% ▲	5% to 8% ▲

FIGURE 4.2: Materials Cost Escalation



ESCALATION

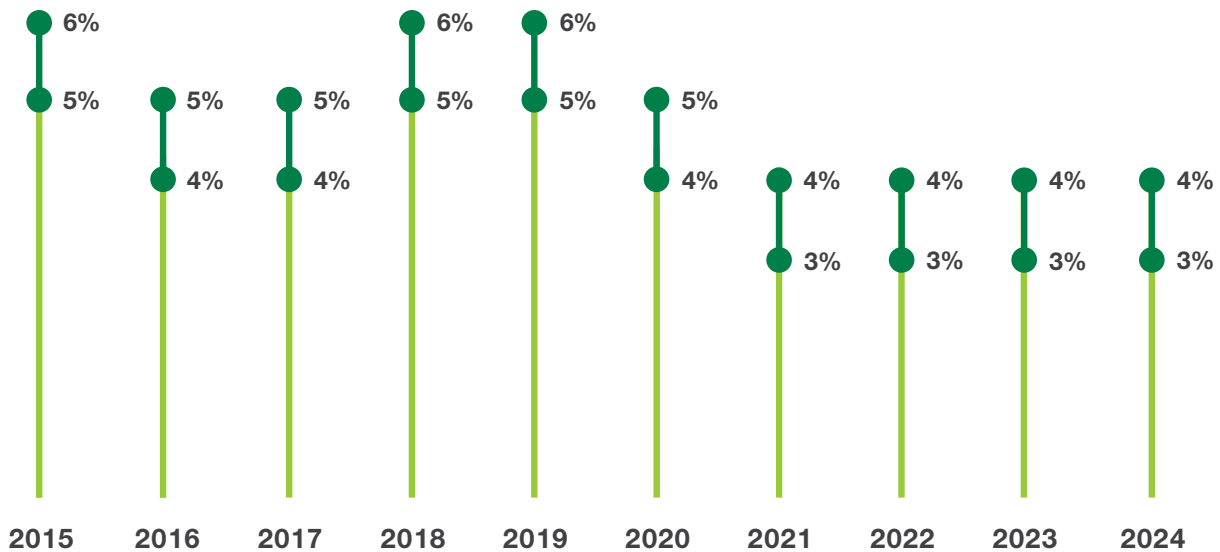
We try our best to take all of the information included in this report and boil it down to a simple escalation rate that applies to the entire value of construction. The chart below shows where we have been, and where we think the costs are trending.

LABOR TRENDS

The labor market supply doesn't match the high volume of work we continue to see in our region, and labor is tight in all trades. Tradespeople have been selective on which projects they choose to work, and they will continue to do so. The trades that will be up for labor negotiations in 2019 will be:

- Communication Workers (non-NECA)
- Glaziers
- Sprinkler Fitters
- Lathers and Sheetrockers
- Drywall Finishers
- Plasterers and Fireproofers
- Carpet Layers (Seattle and Tacoma)

FIGURE 4.3: Annual Escalation



5. SUSTAINABILITY TRENDS

As rating systems evolve and the performance bar raises, both the LEED and the A/E/C industry are at an inflection point with this newest version of LEED.

We'd like to leave you with a quick update on some of the sustainability trends we're seeing in design and construction. As the resources in our world become increasingly scarce, and as we learn more about human health and well-being, Sellen remains dedicated to sustainable practices not only in the way we build but also in the way we live our day-to-day lives.

LEED V4 AND V4.1 UPDATE

LEED remains the world's most widely used sustainability rating system and, for many, the de facto "yardstick" for measuring sustainability. LEED v4 is now the current version, and some owners view LEED certification as an important component of their corporate sustainability commitments. In some jurisdictions, LEED certification is the key to attaining zoning bonuses, so rating systems can have a permitting and financial importance as well.

As rating systems evolve and the performance bar raises, both the LEED and the A/E/C industry are at an inflection point with this newest version of LEED. Sellen is currently working on eight buildings pursuing LEED v4 and is gathering key information on the availability of compliant materials and potential impact on costs. It's fair to say that some designers, manufacturers and suppliers are finding LEED v4 to be a challenge, as some credits have a limited number of compliant products or documentation. In response, the United States Green Building Council has launched a pilot v4.1 rating systems that brings many welcome changes. In some cases, v4.1 offers feasible options to meet rigorous material transparency and low-emitting materials requirements. We are investigating the newly published v4.1 and the potential benefits for our current v4 projects.

Additionally, other sustainable certifications, such as WELL or Zero Carbon, are gaining attention in the industry, reflecting an interest of viewing sustainability through the lens of health or greenhouse gas reduction. While early rating systems – including LEED – covered many topics, they had a heavy focus on operational energy performance. Newer systems are focusing more on health and well-being, as well as carbon emissions.

The industry is still rallying around the basic standards that should be used for materials disclosure.

MATERIALS DISCLOSURE

We are entering a new era of material disclosure as more people understand that by measuring and publishing the environmental impact of materials, projects can make better long-term choices.

The idea of materials disclosure is relatively simple – it's trying to understand every type of material that goes into the making of an object, regardless of scale. While the idea seems straightforward, the execution is anything but, and the building industry has a number of challenges to overcome before materials disclosure can become the norm.

One of the primary challenges is that not everyone thinks about the accessory components, such as glue, and for this idea to truly take hold everyone along the supply chain should be thinking about the materials they are using and identifying those materials. Additionally, the industry is still rallying around the basic standards that should be used for materials disclosure; while norms exist, there isn't one single database where information is easily available. Environmental Product Declarations (EPDs) are an important resource for disclosure, and projects, such as the Helen Sommers Building constructed by Sellen, can be a lever to increase disclosure. For a case study on the new concrete EPDs that this project created, [click here](#).

In the cycle of storming, norming and performing, the industry is somewhere between the storming and norming phase for materials disclosure, but the overall intent is a focus on human health and well-being. It stands to reason that if a material is healthy for the end user, then it should also be healthy for the installer, as well as the manufacturer and any others along the supply chain.



PICTURED: Helen Sommers Building

Codes are a major sustainability and potential cost driver for buildings.

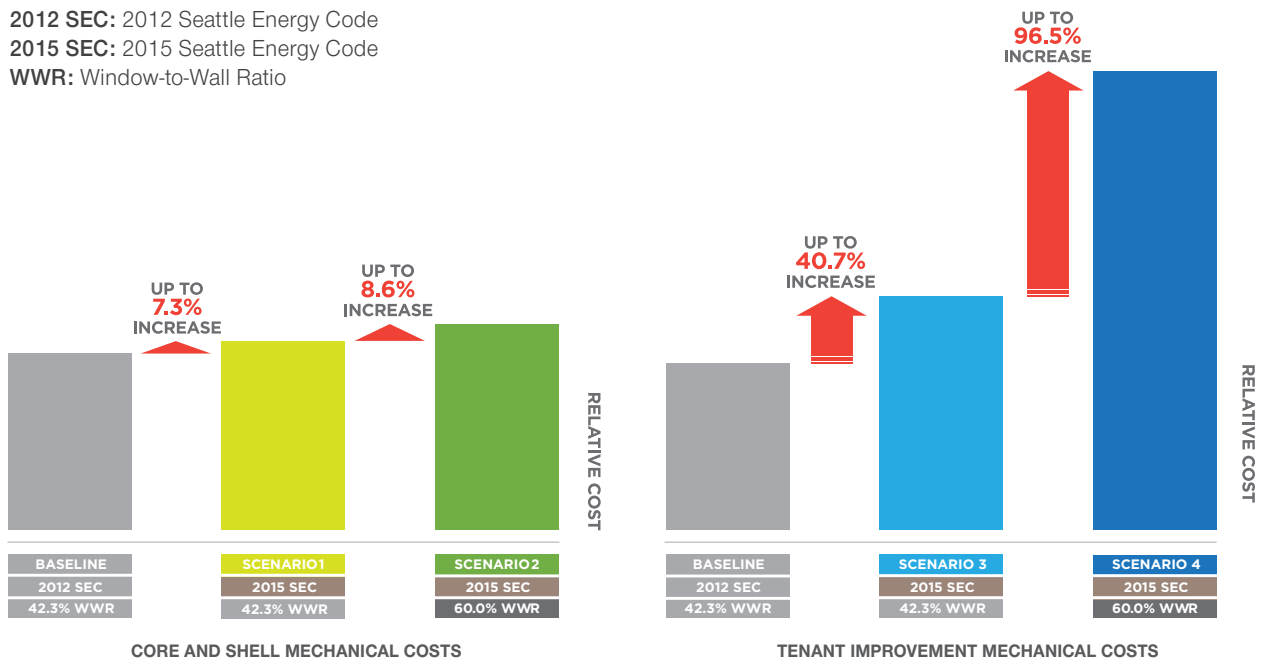
ENERGY CODES

As we discovered last year with the enactment of the 2015 Seattle Energy Code, codes are a major sustainability and potential cost driver for buildings. Washington state will enact a new energy code in 2020 that is less aggressive than Seattle's, but will still have a major impact on costs. We are monitoring how these changes will affect new buildings in the state.

For more information on the effects of the current 2015 Seattle Energy Code, [check out our white paper online.](#)

FIGURE 5.1: Core & Shell and Tenant Improvement Mechanical Costs

2012 SEC: 2012 Seattle Energy Code
 2015 SEC: 2015 Seattle Energy Code
 WWR: Window-to-Wall Ratio



ABOUT THE AUTHORS



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Brad provides overall leadership to Sellen's preconstruction and estimating team members. Prior to taking on this role, Brad served as a project director for many of Sellen's large-scale complex project for over 30 years, including the Bill & Melinda Gates Foundation Campus and the Rufus 2.0 Campus. Brad has a long track record of working closely with owners and developers to deliver projects of the highest caliber.

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With 20 years of experience and strong analytical skills, an attention to detail, and a thorough knowledge of industry trends, he offers our clients creative solutions that add value and flexibility specific to the needs of each project. He has led our teams in the preparation of cost estimates and value recommendations on projects ranging in size from \$1 million to more than \$400 million. Chris often partners with the University of Washington's construction management program as a guest lecturer.

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David is a registered architect with over 25 years of experience working on some of the region's highest performing buildings. With a unique perspective informed by his dual experience in both architectural and construction delivery, David serves as a bridge between designers and builders and excels at identifying sustainability metrics, exploring cost-effective solutions, collaborating with manufactures to lower greenhouse gas emissions, and translating sustainable performance goals into built reality.

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ABOUT SELLEN CONSTRUCTION

Sellen Construction is a locally owned and operated commercial builder. Founded in 1944 and headquartered in the South Lake Union neighborhood of Seattle, Sellen builds iconic projects for the region's tech, science, arts, healthcare and hospitality leaders. We believe in building community by creating unique spaces where significant things happen, and in giving back to non-profit organizations that make our community a great place in which to live and work.

Sellen operates primarily in the Pacific Northwest and offers a wide range of services from preconstruction support, cost estimating and constructability services, to Virtual Design and Construction (VDC), integrated project delivery and sustainability services. Sellen has a Special Projects group that regularly performs renovations and tenant improvements in existing buildings for a variety of office and health care clients. Sellen's notable projects include the Bill & Melinda Gates Foundation Campus, Seattle Children's Hospital Building Hope Expansion, the Museum of History and Industry at South Lake Union, King Street Station Restoration, and the new Amazon office towers in Seattle's Denny Triangle neighborhood.

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