



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Katy Allen
William F. Sherry, A.A.E.

SUBJECT: SEE BELOW

DATE: 04-06-09

Approved

Date

4/10/09

COUNCIL DISTRICT: Citywide

SUBJECT: APPROVAL OF THE FOURTH AMENDMENT TO THE CONTRACT WITH HENSEL PHELPS CONSTRUCTION COMPANY FOR THE DESIGN AND CONSTRUCTION OF THE AIRPORT TERMINAL AREA IMPROVEMENT PROGRAM

RECOMMENDATION

- a) Approve the fourth amendment to the contract with Hensel Phelps Construction Company for design and construction of the Airport Terminal Area Improvement Program to:
- Allow for the early release of Design-Builder Contingency;
 - Allow a modification to the retention formula;
 - Allow for early acceptance of equipment warranties for the Terminal A Modifications Project Element; and
- b) Adopt a resolution increasing the City Manager's authority to negotiate and execute contract change orders for the City-Controlled Program Reserve from \$67,165,000 to an amount not-to-exceed \$84,862,000.

OUTCOME

Approval of these recommendations will:

- Allow the City to capitalize on changes within the construction industry and use savings within the Hensel Phelps contract to recapture scope that was eliminated during early design stages;
- Increase the City Manager's authority to negotiate and execute change orders through the City-Controlled Program Reserve to the Hensel Phelps contract.

Approval of these recommendations will not change the total not-to-exceed compensation for the City's Design-Build Contract with Hensel Phelps, and will provide only for expenditures of funds already identified and approved through previous Council action.

EXECUTIVE SUMMARY

Staff recommends amending the Design-Build Contract with Hensel Phelps Construction Company to allow the following:

- Allow the City to draw down a portion to the Design-Builder Contingency and move the City's portion of the contingency among other project element budgets;
- Alter the retention formula;
- Allow early acceptance of equipment warranties for the Terminal A Modifications Project Element;
- Increase the City Manager's authority to negotiate and execute contract change orders.

Hensel Phelps was selected to construct the modernization program for Norman Y. Mineta San José International Airport in 2006. Construction is underway and the project is proceeding on time and on budget. The declining construction market has resulted in lower contractor and subcontractor bid pricing which has allowed the Design-Builder to preserve (rather than draw upon) the Design-Builder Contingency that was agreed to by the City as part of the Guaranteed Maximum Price (GMP) negotiations. This, in turn, has opened opportunities to utilize that forecast savings to capture more scope within the existing program budget. In order to do that, staff proposes liquidating \$10 million of the Design-Builder Contingency now held by Hensel Phelps. Staff also recommends granting authority to the City Manager to continue to draw down the remaining contingency at appropriate times in the project to maximize scope.

In exchange for the early return of this contractor-controlled contingency, Hensel Phelps has requested a modification to the retention formula and early relief for equipment warranties in Terminal A.

Staff has analyzed the risk associated with these changes and determined that a prudent course of action would be to modify the contract at this time to allow a phased liquidation of \$10 million in contingency and to authorize the City Manager to liquidate additional contingency funds as the project nears completion. Hensel Phelps' requests for contract modification are fair exchange for the increased risk associated with the contingency drawdown.

BACKGROUND

On October 17, 2006, Council approved a contract with Hensel Phelps for the design and construction of the Airport Terminal Area Improvement Program (TAIP) in the amount of \$488,211,000, with a \$24,560,000 City-controlled design and construction contingency, for a total not-to-exceed amount of \$512,771,000. To date, Council has approved two contract amendments in the amount of \$118,274,000 to increase the scope of the Consolidated Rental Car facility and align financing, to better address stakeholder needs. Council also recently approved a third amendment in the amount of \$27,933,000 to include the Terminal A Equity program

within the Hensel Phelps contract scope. The City Manager has approved contract change orders in the amount of \$51,849,448, consistent with the terms of the contract, Council direction, and City Manager authority. The current total not-to-exceed compensation for the contract is \$710,827,448.

Council also approved a City-Controlled Program Reserve for the TAIP, to provide for additions to the scope of the program. The authorized total for this program reserve is an amount not-to-exceed \$67,165,000. This amount is not included within the Hensel Phelps contract.

ANALYSIS

When the original contract was awarded to Hensel Phelps in October 2006, construction was escalating at approximately 12% to 15% per year and the contractor informed the City that the construction program would cost about \$150 million more than the budget allowed. As a result, the City and contractor significantly modified the scope of some Project Elements, including Terminal A Modifications, and deferred work on the Public Parking Garage. Today the project is approximately \$2 million over its base budget, but the City is holding ample reserves to cover the shortfall.

Considering the economic conditions today with a flat to very low escalation environment, highly competitive subcontracting environment, and a ready and willing labor force; it is prudent to re-examine the financial status of the project in the context of its scope. Because the construction environment is so positive today and because we have a negotiated contract as opposed to low bid, staff has negotiated a scope buyback contract amendment with the following provisions.

1. Amendment to allow contingency drawdown

Construction of the TAIP is authorized through the negotiation and execution of design-build task orders for individual project elements. The design-build task order and accompanying plans and specifications form the contract for construction of that particular element. Contained within the task order are a Guaranteed Maximum Price (GMP) and a Design-Builder Contingency. The contract stipulates that upon completion of a Project Element of the program, the City and contractor share the unused contingency 75% to 25% respectively.

Below is a list of active construction task orders along with the GMP amount and the Design-Builder Contingency.

Project Element	GMP Amount	DB Contingency
Terminal A Modifications and Inline Baggage	\$103,382,154	\$12,740,749
Terminal B, Ph I and Baggage	\$127,935,772	\$13,794,434
Terminal Equity	\$20,894,069	\$2,212,615
North Concourse FF&E and Signage	\$2,992,342	\$227,152
Surface Parking	\$2,554,935	\$197,218
Roadways	\$98,114,255	\$7,546,507
Rental Car Garage/Public Parking	\$218,504,250	\$21,349,414
Totals	\$574,377,777	\$58,068,089

To date, Hensel Phelps has identified less than \$2 million of exposure to contingency claims. The low amount of contingency utilization is primarily attributable to the fact that Hensel Phelps is experiencing *buy out savings* within the GMP. Buy out savings refers to a situation where the price being paid for base scope by Hensel Phelps is less than the amount agreed to in the GMP. Buyout savings are occurring because escalation is nearly flat and competition for these subcontracts is fierce. The City will receive 100% of the buy out savings back from Hensel Phelps once the project element is complete. Hensel Phelps has offered to immediately release \$5 million from the Design-Builder Contingency. The second phase of the drawdown will release another \$5 million when the City and Hensel Phelps agree that the risk is favorable. At this point the City will modify the retention formula as described below.

2. Amendment to alter retention formula

The City Standard Specifications require withholding a percentage of the monthly payment to contractors. This practice is known as *retention*. The standard retention formula for all City construction contracts is such that the City retains 10% of all monthly payments until 50% of the work is completed. At the 50% completion point, if the work is proceeding satisfactorily, the City may elect to reduce the amount retained to 5% of the total held and may reduce future retention to 5% of the monthly payment. When the project reaches 95% completion and if the work is proceeding satisfactorily, the City may elect to reduce the retention again, but to no more than 125% of the estimated value of the remaining work yet to be completed.

Due to the longer than usual nature of this contract, the size of the contract, the progress being made, and in exchange for the increased risk of contingency release, Hensel Phelps has requested relief from the retention requirements in the following manner.

When the City and Hensel Phelps agree to a total of \$10 million in contingency liquidation, the City will modify retention as follows: The City will reduce the amount retained to 5% of the total held and will reduce future retention to 5% of all monthly payments until 50% of the work is completed. At the 50% completion point, if the work is proceeding satisfactorily, the City may elect to reduce the amount retained to 2.5% of the total held and may reduce future retention to 2.5% of the monthly payment. When the project reaches 95% completion and if the work is

proceeding satisfactorily, the City may elect to reduce the retention again, but to no more than 125% of the estimated value of the remaining work yet to be completed.

3. Amendment to allow early relief of warranty requirements for the Project A Modifications Project Element

The contract currently provides that all equipment warranties commence when the project element is formally accepted by the City. Since Terminal A is operating during the construction, portions of the building have been turned over to public use. Those areas have equipment that is being operated for its intended use. As a result, certain equipment warranties in Terminal A have been effectuated by the manufacturer. The proposed contract amendment contemplates allowing the City to accept warranties for equipment installed and operating for its intended use in Terminal A prior to formal acceptance. Warranties likely to be started early include elevators, escalators, air handling units and switchgear. All warranty terms as provided in the contract will remain unchanged, but the start date of the warranties in Terminal A will commence prior to the City's acceptance of the entire Terminal A Modifications Project Element in those situations where the equipment has been placed into use prior to Project Element acceptance.

Resolution to increase contract authority

The increase in City Manager's contract authority reflects expenditures for three elements; funding for these elements has already been authorized through previous Council action:

- \$14,900,000 for baggage system enhancements requested by the airlines, included in the budget action taken by Council on February 10, 2009;
- \$1,397,000 for a rain canopy on the airside of Terminal A that was included in the annual report approved by Council on October 21, 2008;
- \$1,400,000 for Terminal A building controls modernization, included in the adopted 2008-2009 capital budget and 2009-2013 Airport Capital Improvement Program.

The proposed \$17,697,000 increase results in no net increase to the budget. It does, however, restore the City Manager's authority to the same funding level that existed prior to the baggage system enhancements and rain canopy addition, and it directly allows the City Manager to negotiate and execute a change order for the Terminal A building controls without impacting the restored funding authority.

Terminal A building controls

As part of the effort to cut \$150 million from the original airport improvement program, staff excluded the modernization of Terminal A building controls from the project scope. However, the original manufacturer is no longer supporting the existing software and hardware, and staff has determined that modernization of these controls is critical. The Airport identified \$1,400,000 within the adopted 2009- 2013 Airport Capital Improvement Program for this project, and staff

recommends that the Program Reserve be increased as described above to fund the Terminal A building controls work scope under the Terminal A Modifications Project Element. This recommendation is based on the following key considerations: (1) the City will benefit from the negotiated price structure in place with Hensel Phelps; (2) there will be no operational or post-construction impact to tenants and customers; and (3) the City ensures consistent building control technology throughout the Airport, which helps insure equity of these improvements with the new terminals and translates to ongoing operational and cost benefits for maintenance and service.

POLICY ALTERNATIVES

Alternative #1: Not approve the recommendation.

Pros: Project savings and unused contingencies returned to the City at the end of the project can be used to pay down debt.

Cons: Project has missing scope.

Reason for not recommending: Airlines and tenants have approved the program assuming the full expenditure of funding with the understanding that the scope agreed to is fully funded.

PUBLIC OUTREACH/INTEREST

- ✓ Criterion 1: Requires Council action on the use of public funds equal to \$1 million or greater; **(Required: Website Posting)**
- Criterion 2: Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3: Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This item meets Criteria 1: Requires Council action on the use of public funds equal to \$1 million or greater. This memo will be posted on the City's website for the April 28, 2009 Council meeting.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office and the City Manager's Budget Office. This item has also been coordinated with the airlines; they are in agreement and support the recommendation.

FISCAL/POLICY ALIGNMENT

The San José Municipal Code requires that capital projects at the Airport be consistent with the adopted Airport Master Plan. As the Terminal Area Improvement Program consists of projects expressly identified in the adopted Airport Master Plan, this proposed amendment to the Program’s design-build contractor is consistent with the Airport Master Plan pursuant to Municipal Code Section 25.04.210(B)(2).

This project is consistent with several initiatives identified in the Economic Development Strategy adopted by Council in November 2003, and aligns most significantly with *Strategic Initiative #1: Build a World-Class Airport and Air Service*.

This project is also consistent with the Guiding Principals for Budget and Financial Management in the Mayor’s 2006-2007 Revised June Budget Message by supporting economic recovery and job creation.

COST SUMMARY/IMPLICATIONS

There are no new costs associated with this item. There is no impact to the General Fund.

BUDGET REFERENCE

The table below identifies the fund and appropriations proposed to fund the remaining project costs, including project delivery, construction, and contingency costs. Services performed by Hensel Phelps under this agreement will be authorized by task order. An appropriation is not required for execution of the proposed fourth amendment to the design-build contract but is required for each task order authorized under this contract.

Fund #	Appn #	Appn. Name	Total Appn	2008-2009 Adopted Budget Page	Last Budget Action (Date, Ord. No.)
520	5253	Terminal Area Improvement, Ph1	\$18,135,000	V-998	2/10/09 Ord. No. 28492
526	5253	Terminal Area Improvement, Ph1	\$115,549,000	V-998	2/10/09 Ord. No. 28492
527	5253	Terminal Area Improvement, Ph1	\$7,463,000	V-998	10/21/08 Ord. No. 28422
529	5253	Terminal Area Improvement, Ph1	\$24,417,000	V-998	6/24/08 Ord. No. 28349
526 (528)	4164	Consolidated Rental Car Facility	\$37,338,000	V-986	10/21/08 Ord. No. 28422
526 (555)	5246	Public Parking Garage	\$2,005,000	V-988	10/21/08 Ord. No. 28422

HONORABLE MAYOR AND CITY COUNCIL

Subject: Fourth Amendment to Hensel Phelps Construction Contract for the Design-Build of the Airport Terminal Area Improvement Program

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520	4657	North Concourse Building	\$14,240,000	V-994	2/10/09 Ord. No. 28492
526 (548)	4657	North Concourse Building	\$30,052,000	V-994	2/10/09 Ord. No. 28492
527	6513	Terminal A Control Systems	*\$600,000	V-997	6/24/08 Ord. No. 28349

*The adopted 2009-2013 Airport Capital Improvement Program includes \$832,000 for Terminal A Control Systems in 2009-2010; however, the Airport is recommending a reduced allocation of \$800,000 as part of the Proposed 2010-2014 CIP.

CEQA

CEQA: Resolution Nos. 67380 and 71451, PP 09-063

Katy Allen

KATY ALLEN
Director, Public Works Department



WILLIAM F. SHERRY, A.A.E.
Director of Aviation

For more information or answers to questions, please contact HARRY FREITAS, Deputy Director of Public Works, at (408) 501-0137.