Santa Clara Valley Water District

2026 Escalation Project Report

Santa Clara County, CA

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INTRODUCTION

To support the Santa Clara Valley Water District "Valley Water" planning goals with respect to capital planning, construction planning and financial analysis in the 2026 fiscal year OCMI has been asked to provide a market study that provides analysis of current and projected future market conditions.

SUMMARY ANALYSIS

National Construction Market

As the large tranche of construction projects that began in 2022-24 reach the end of their spending curves, interest rates remain high and market-wide uncertainty prevails. Net demand for construction, and overall construction volume, is likely to wane through the end of FY25 and most of FY26, particularly across the private sector. Overall contractor 'hunger factor' is likely to increase moderately through Q1 or Q2 FY26. A gradual revival of volume is forecasted to begin in late FY26, with 'normal' supply/demand balance realized in FY28.

Material / Equipment

Contemporary federal action related to the possible implementation of trade tariffs has caused – at least temporary – volatility in some material markets. Even if not ultimately codified, the market's reaction to the specter of tariffs will likely result in a 10-15% increase in construction material pricing in FY25. Going forward, we expect a swift return to high-end-normal material escalation rates in FY26 and FY27. In the out years of FY28 through FY30, longer term evolutions in international trade dynamics could result in above-average material price growth in a given year.

Equipment costs (referring to the non-permanently installed equipment required for construction, e.g. excavators, trucks, rentable crewed machinery) are forecasted to see a slightly delayed impact from the international trade dynamics that are currently evolving. Particularly in FY26 through FY29, we expect above-average growth in equipment costs; resultant of higher replacement part costs from overseas manufacturing centers, rising (compared to current) energy pricing over the coming years, and complications in supply chain from the domestic re-shoring of manufacturing that may manifest in FY28-FY30.

Labor

Overall construction labor roles have continued to decline since our last report, but the rate of reduction has decreased over the course of 2025 with a net loss of 500 jobs for the period. Large infrastructure investments county wide, paired with impediments to traditional hiring practices in trades that are heavily utilized in infrastructure projects, will serve to continue to provide inflationary pressure on local wages. Selective savings in vertical or other specialty construction projects are possible due to the paucity of competing vertical work.

Competition

Low levels of private sector construction activity have continued to stimulate interest in the public construction sector, and bidder interest in infrastructure and civic projects has risen markedly over the last 12 months, with public projects routinely seeing as many as 10 interested parties per project. Though not all of these parties tend to bid each individual project, the net effect has been an average bidder turnout that well exceeds previous years. However, this increased interest in the public sector has yet to translate to markedly lower expectations on the part of these same bidders in terms of overhead and other contractor driven costs.

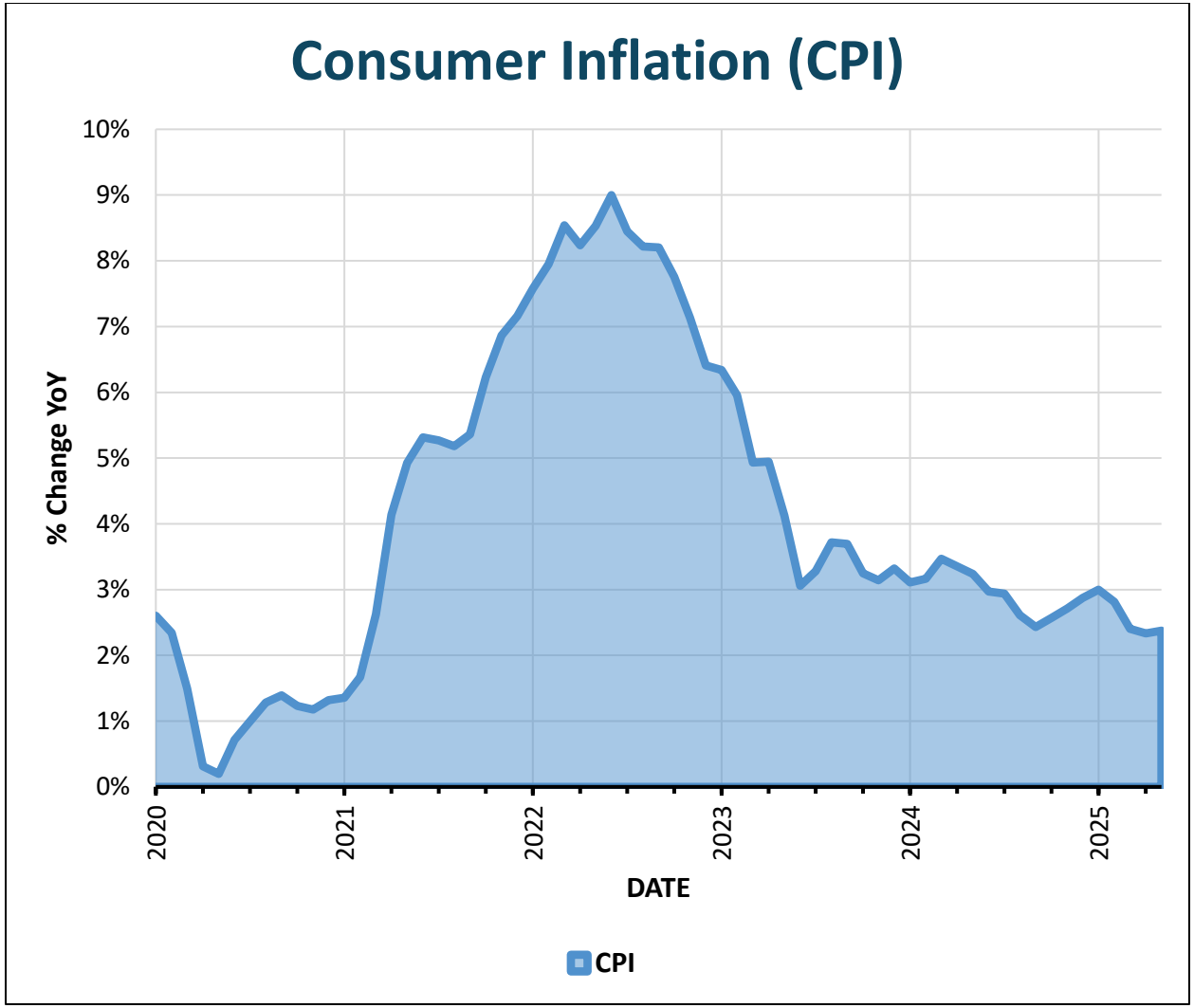
Conclusions

Despite instability in wider economic markets and federal initiative direction, the greater Santa Clara County construction economy has continued to see growth over the last twelve months. Continuations of trends seen last year, namely a flight to public construction in the face of declining private sector volume, continue to be prevalent in the marketplace- though current and future planned investments into artificial intelligence are anticipated to lead to rapidly increasing volume in the private sector once interest rates decline in early/middle 2026. Material price fluctuations across the wider construction industry will continue to exert influence on both direct contractor pricing and risk-related premiums and contingencies, and it is anticipated that though interest in Valley Water projects will continue to grow in the short term this is not likely to translate to significant savings in terms of contractor overhead, profit and general conditions costs. Continued shortages in labor, exacerbated by the Pacific Palisades fire in Los Angeles, will continue to serve to raise commanded wages area wide- in some cases by as much as 30% depending on the trade. Marked growth in directly competing projects, namely multibillion infrastructure initiatives, will make the acquisition and retention of qualified sources of labor more costly and require increased coordination with contracting partners to ensure a continuous flow of resources to Valley Water construction priorities.

OVERALL ECONOMIC CONDITIONS

CONSUMER INFLATION

National inflation rates, which had been on a downward trend over the course of 2024, have begun to show signs of renewed movement upward. An increase of .5% from the end of last year to 2.8% was observed through February of 2025, but slight increases in optimism regarding trade policy have resulted in a downtick to 2.3% as April 2025 data, yielding an aggregate increase of .1% over the first quarter. Increased market and public policy volatility have led to markedly lower consumer confidence index readings, which has resulted in the highest levels of concern about long-term inflation since the early 1980s. This, paired with concerns about slowing levels of economic growth, is leading to further concern about a "stagflation" event, or a situation in which the economy is declining even as interest rates rise. Should this precipitate itself, the Federal Reserve would have to choose whether to attempt to stimulate the economy by dropping interest rates, thereby potentially increasing inflation, or increasing interest rates and thereby furthering economic decline. With neither of these choices considered to be particularly favorable, this outcome represents the most negative of the possible outcomes currently contemplated.

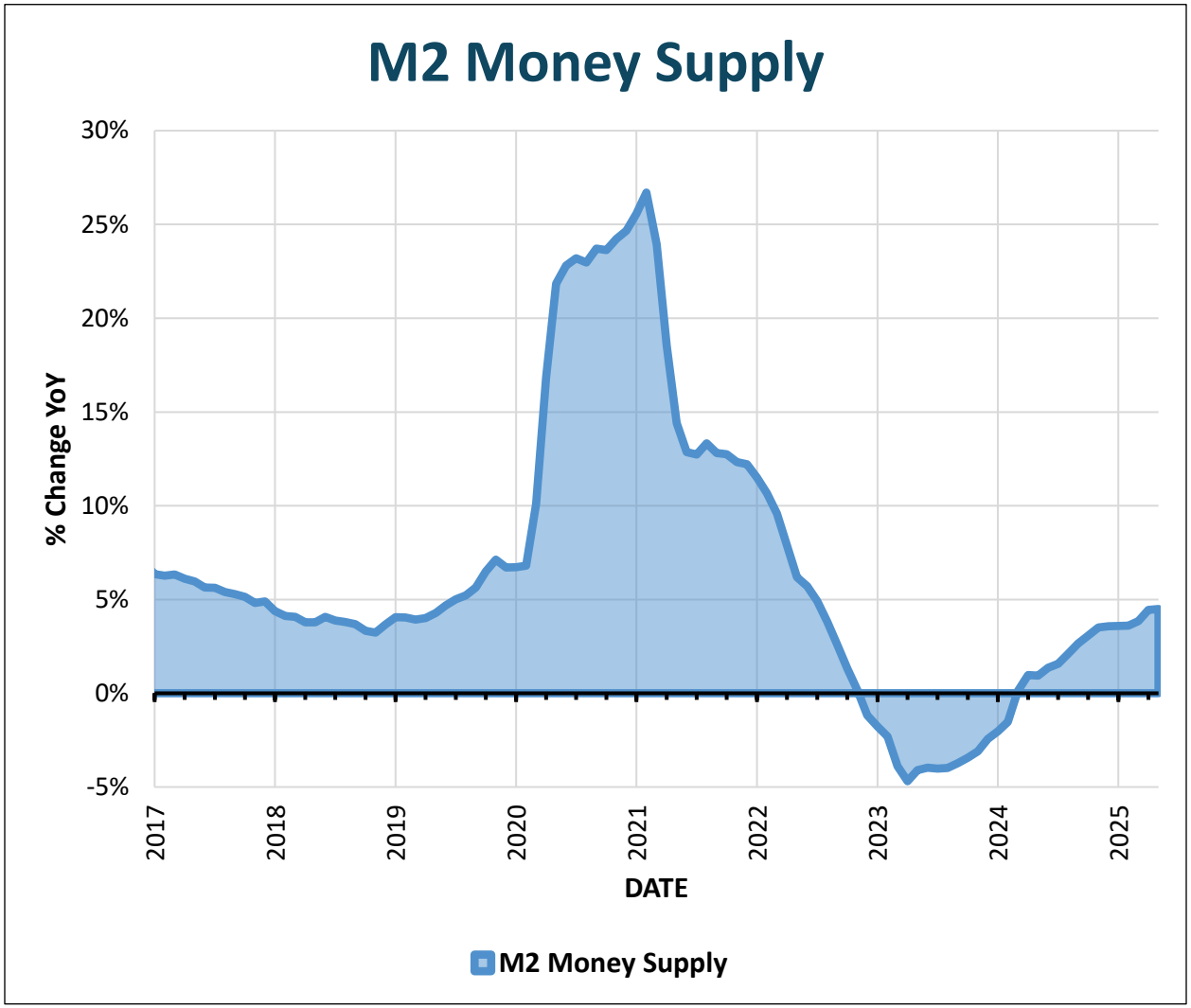


TARIFFS & TRADE POLICY

Current federal trade policy, though still very much in flux, is the largest potential catalyst for interest rates in the short and medium terms. Though recent suspensions of most of the announced tariffs points to potential for changes to these expectations, a return to the previously announced adjustments to US trade policy would likely result in higher inflation, with rates unlikely to stabilize until passed fully through to the consumer. This increased volatility has resulted in an alteration of short to medium term expectations for federal interest rates, and the current messaging from the Federal Reserve suggests that interest rates, which were projected previously to fall this year, are likely to remain unchanged in 2025. It should be cautioned that the situation is still highly fluid, and Jerome Powell, the Chairman of the Federal Reserve, has made several comments about the possibility of interest rate reductions were concerns about inflation to ameliorate. However, concerns about the aforementioned "stagflation" are likely to cause the Fed to continue to be reasonably cautious about adjustments to rates in favor of leaving the option as a possibility for later to counter adverse market reaction to new policy.

M2 MONEY SUPPLY

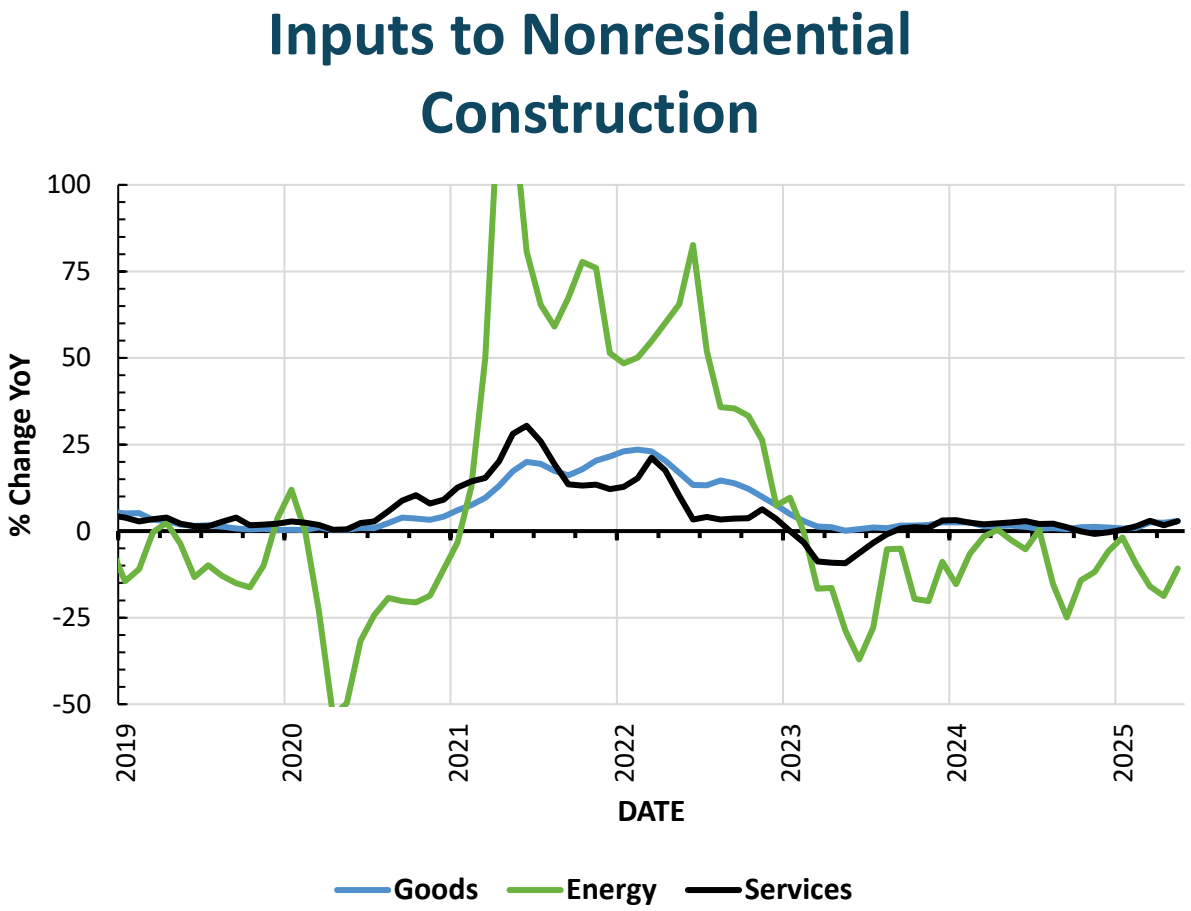
The M2 money supply, which is a measure of the total US monetary supply and includes M1 (physical currency and demand deposits) plus savings deposits, small-denomination time deposits, and retail money market funds, began to climb in early 2024 after seeing a decline from the all-time high of $22T, set in April of 2022. Though increases over the last twelve (12) months have been less dramatic than those observed in the period immediately following the COVID pandemic, they have still been enough to post a total increase of $1T over the period. Increases in total monetary supply from the pandemic to now have totaled roughly 40%, and these increases in total available monetary stock account for a large portion of the perceived increases in construction activity over the same period. In fact, if one controls for total inflation over the period, which is roughly 40%, total US put in place construction for 2025 is projected to be roughly 17% above the levels observed in 2019 ($1.6T vs. 1.37T).



ENERGY PRICING

Energy pricing is a tremendously important component of construction costs due to its use at multiple stages throughout the lifecycle of the production, transportation and installation of materials and equipment. Domestic energy costs, measured by the per barrel West Texas Intermediate (WTI) price of oil, have declined each of the last three (3) years and are currently sitting just above $60/barrel.

This decrease has been predicated on both declining domestic demand and increased international production, and domestic producers have responded to these conditions by slowly trimming production investments. Active domestic wells/drilling rigs have declined each year since 2022 and, as of the second week of April 2025, are standing at 6% below their level at the same time last year. Despite these reductions, the supply for each of those three years has risen modestly, and 2025 is forecasted to see a continuation of the same trends with moderate rises in supply coupled with lower investment in production equipment. Nondomestic producers, notably OPEC, have and are expected to continue to increase supply in a bid to further reduce competition from other producers. Though this will result in lower energy pricing in the short term, the distance and difficulty of transporting energy coupled with the rising degree of geopolitical conflicts in the area in which OPEC extracts their products makes the possibility of a “black swan” event, or a situation in which international supply drops precipitously and/or prices rise markedly in a short period of time, more likely. Should this occur, the decreases in domestic production investment will take time to reverse, which would lead to significant inflation in energy market pricing until new production options are brought online. Because of these conditions current energy pricing presents an opportunity for savings, especially in the operation of heavy equipment, but also represents one of the larger potential horizon risk events.



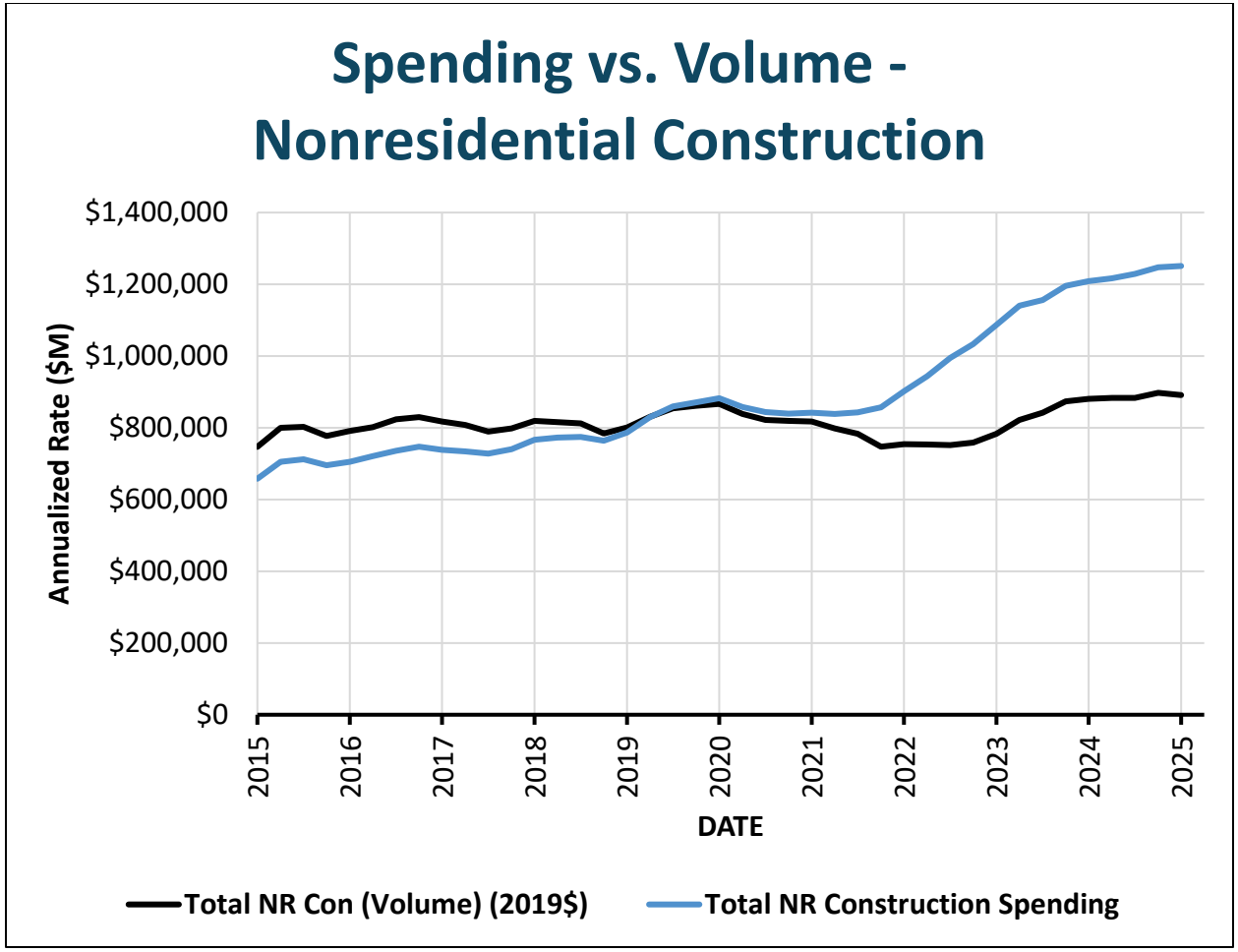
CONSTRUCTION DEMAND

CONSTRUCTION SPENDING & VOLUME

At a nominal level (blue line), Total Nonresidential Construction Spending (TNRCS) in the US has rebounded from post pandemic-onset dip since September of 2021, with annualized rates of construction spending reaching new highs nearly every month since.

Importantly, though, the reported spending values are not controlled for escalation; monetary inflation or otherwise. While it is difficult to apply a perfect adjustment methodology, the graph to the right demonstrates the results of adjusting the data to reflect 2019 dollars (black) by using the Bureau of Labor Statistics' 'Final Demand for Construction Producer Price Index.' With this illustration, it's clear that the steep, upward trend in nominal spending is not strictly in correlation with the actual volume of work being accomplished. Compared to 2019, Nonresidential Construction Spending has finished each year:

- 2020: -0.06%
- 2021: -6.16%
- 2022: -9.82%
- 2023: -0.85%
- 2024: +5.98%



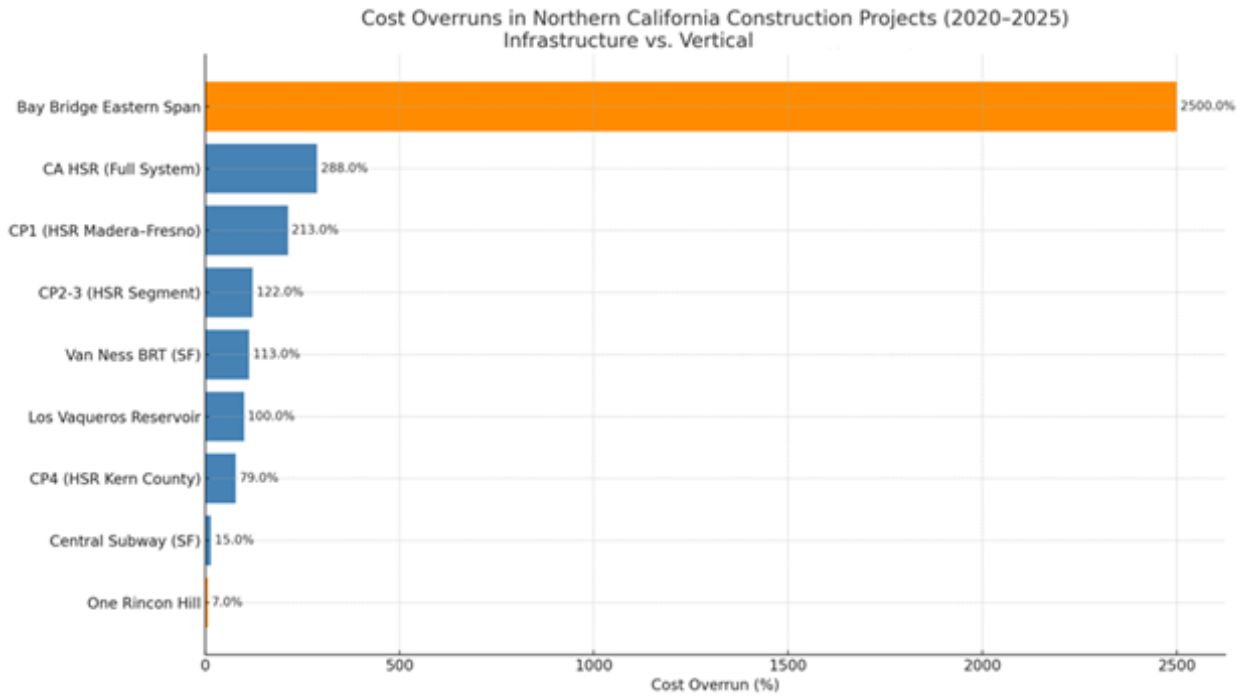
PROJECTED CONSTRUCTION ACTIVITY, HUNGER FACTOR AND BIDDING CONDITIONS

Looking through the end of the calendar year, the current approach of contractors surveyed can be summarized as: bidding more, but not yet cutting margin. Contractors are beginning to broaden their go/no-go selection criteria – both at the general and subcontractor level – in an effort to bolster their backlog. However, this broadened attack-pattern is not yet accompanied by 'sharpened pencils' with more aggressive, lower margin costs.

A review of publicly available bid and change order data for current and recently completed infrastructure costs helps to inform expectations for future bidding conditions. Looking at large infrastructure projects since 2020 it becomes clear very quickly that cost overruns appear to be more likely than not, with almost all projects seeing double digit price increases relative to Prebid estimated amounts. These margins rise as project costs and complexity rise, indicating that the larger the project, the more likely one is to see a significant variance between estimates and contractor bids. These variances have been driven by a host of factors, including the shortages brought on by COVID, but their persistent role in market pricing demands that they be factored in when evaluating and valuing projects.

As backlog continues to dwindle and contractor hunger factor continues to increase we anticipate seeing a degree of reduction in contractor fees and overhead, but a reversion to pre-COVID dynamics is not, at this time, anticipated. Current volatility in materials, international trade and federal policy making will continue to create above average perceptions of risk, regardless of volume, which will continue to lead to higher than average bid pricing at all volume levels.

	FY25 Bid Projects to date (7-29-25)	Bid Opening Date	No. of Bids	Winning Bid	Average Bid	Engineer's Estimate	EE vs W. Bid % Diff	Notes
1	C0705 - West Pipeline Inspection & Rehabilitation Ph. 1 Project	11/13/2024	3	$ 12,488,800	$ 16,526,832	$ 21,827,748	-43%	Awarded
2	C0713 - Security Upgrades & Enhancements Project	11/20/2024	3	$ 2,194,000	$ 3,228,604	$ 3,540,938	-38%	Awarded
3	C0708 - Stevens Creek Evelyn Fish Passage Project	10/16/2024	2	$ 4,852,260	$ 5,273,130	$ 5,320,000	-9%	Awarded
4	C0707 - Permanente and Hale Creek Concrete Channel Repair Project	4/26/2025	7	$ 1,384,450	$ 2,188,469	$ 2,984,504	-54%	Awarded
5	C0716 - South Babb Creek Mitigation Project	6/11/2025	4	$ 1,225,742	$ 1,527,456	$ 1,607,055	-24%	Awarded
6	C0710 - Palo Alto Flood Basin Tide Gate Structure Phase 1	7/2/2025	5	$ 2,782,645	$ 2,942,215	$ 2,468,405	13%	Awarded
7	C0715 -Calabazas Creek Erosion Repair Project	5/27/2025	4	$ 1,148,268	$ 1,204,043	$ 1,241,760	-7.5%	Awarded



LOCAL ECONOMIC OVERVIEW

LOCAL CONSTRUCTION ECONOMY

Santa Clara County covers a large portion of the southern Bay Area and runs from Palo Alto in the north past Gilroy at its southernmost point. and is the most populous county in Northern California and the 10th most populous county in the United States. Because of the size of the area and its proximity to San Francisco it is often evaluated in tandem with wider economic trends that effect the area broadly, but the density of both local construction volume and population necessitates a more tailored, specific approach to evaluating its current and future economic conditions.

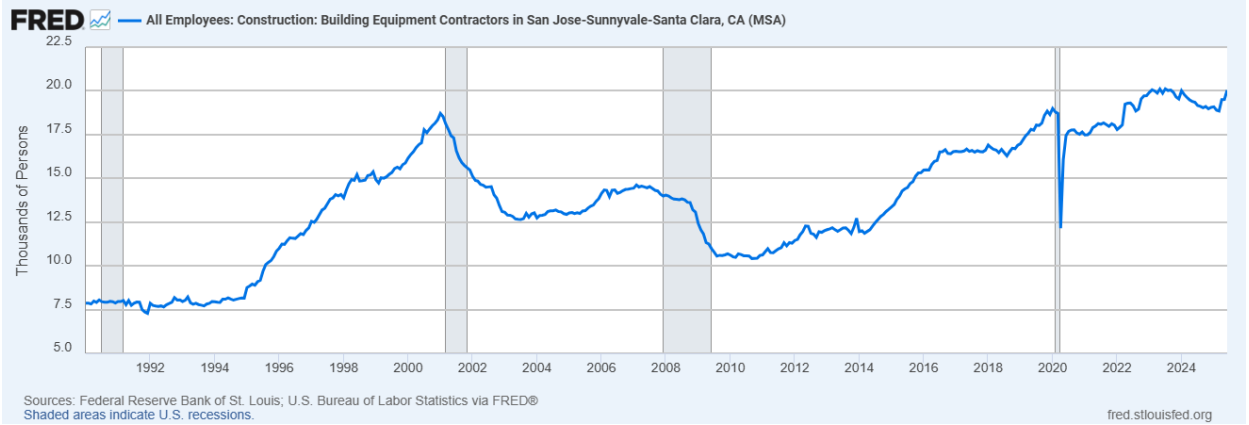
The second half of the 2024 calendar year and the first half of 2025 have been, to a large extent, a continuation of the significant trends that have and will continue to exert a large amount of influence on the pricing environment for construction projects, especially large projects, that were noted in our previous report. National interest rate movement, discussed in greater detail in a separate section of this report, has bucked expectations and have remained unchanged from the levels set in previous years. Though this may change as the current administration has indicated a wholehearted preference for rate reduction, the Federal Reserve has traditionally shown that, if forced to a binary choice, they would prefer mildly detrimental economic outcomes driven by an overly conservative approach to a rapid inflation environment brought on by a more aggressive one. This native orientation, combined with increased concerns about currency health and the outcomes of current federal trade policy, lead to the natural conclusion that as long as the makeup of the leadership of the Reserve stays consistent their approach to the management of national interest rates will as well. These increased rates, as noted in our previous report, have had a significant effect on the broader spending plans of businesses across the country, but none more so from a sector perspective than the technology market to which San Jose specifically and Santa Clara County broadly are so inextricably tied. When rates were originally increased, and then held at increased levels, a wave of staffing reductions and other cost saving measures were triggered across the technology sector that had a measurable effect on the wider Santa Clara County area- so much so that the sector currently accounts for 15% fewer total jobs today than in 2021 (91,500 vs. 108,000).

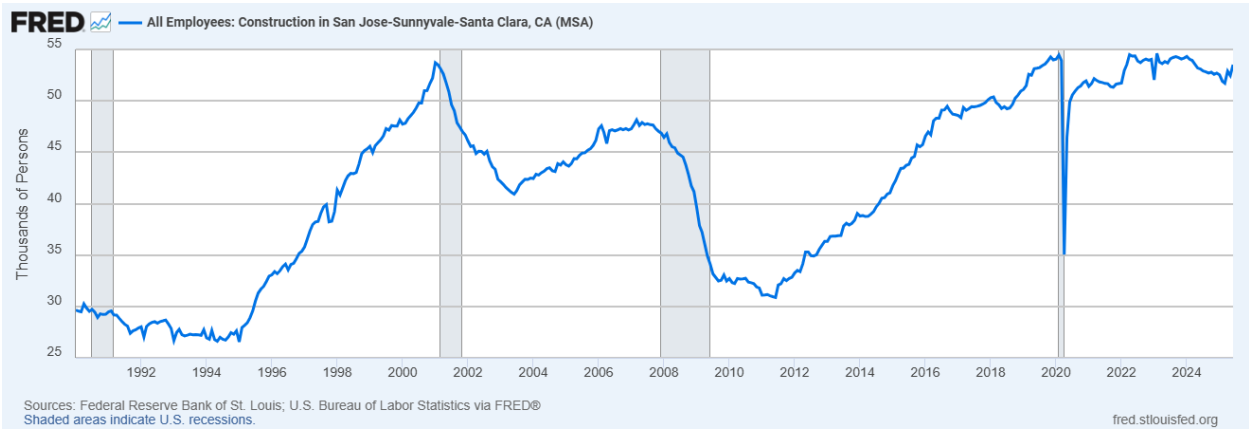
County wide unemployment has increased by roughly 1% year-over-year (YOY), with roughly 5,000 fewer full-time jobs across all sectors from the summer of 2024 to the summer of 2025. At the same time the total labor force for the area has expanded, in large part due to Return to Office (RTO) mandates as the effects of the pandemic continue to wind down, with approximately 5,500 more available workers now than at this time last year. Though this continued decline in total employment is not a positive metric on its own, it should be noted that it's 50% better than the reported unemployment rate at this time last year- indicating a slow, but measurable, return to normalcy. Gains in county Gross Domestic Product (GDP), which is a measure of the total value of the goods and services produced in the area, have seen declines from the recent highs set in 2022/2023 (6.5%) to just over half of that (3.4%) from 2023-2024. Though total GDP figures for 2024 and into 2025 are not yet available, it is anticipated that total growth will once again reflect a decrease from the levels observed in the immediately preceding years. Though this can certainly be perceived to be a long-term positive in terms of helping to moderate growth to a sustainable level from the 30% total growth seen between 2020 and the end of 2023, it is also undeniably indicative of a continuing slowdown in the local economy.

Construction specific labor has likewise continued the trends noted at the end of 2024. From a national perspective, construction labor at all levels- whether that be supervisory, in office or onsite- all continue to see an increasing difficulty in hiring for the construction sector. Surveys done in Q1 of 2025 point to an astonishing 94% of firms reporting difficulties in hiring for trade positions, while those same firms report only slightly fewer difficulties (92%) in hiring for salaried positions. This is a remarkable figure, but is made even more so when one factors in that both of these numbers are roughly 5% above the levels shown in a similar study in 2023. From a Santa Clara County specific perspective, labor based shortages are continuing to exert significant impact on bottom line construction pricing. Continued shifts from vertical construction to more infrastructure/horizontal

projects that were observed beginning in 2024 have altered the trades seeing the worst shortfalls over the last two years, though, and in lieu of carpenters and electricians' local unions are reporting the most significant shortages in the cement mason, plumbers/pipefitter and heavy equipment operator trades at present. These shortages have not been significant enough to stymie the ability to hire market wide entirely, though, and equipment operator positions are currently at an all-time high for the region at just over 20,000 full-time jobs. Across all sectors the market has seen a very slight reduction (-300 full time positions) over the course of 2024-2025, but it is anticipated that most of these reductions are owing to the spending curves of the larger projects undertaken in 2023 reaching their zenith and beginning to trend back down.

It should also be noted that the current federal administration initiative aimed at reducing employment and residency for undocumented persons has the capacity to have a measurable, sustained effect on labor pricing across the county, the wider state and indeed the country as a whole. There are obvious predictable difficulties in getting accurate reporting on the lives, occupations and other day to day realities of the undocumented residents of both the country at large and the county in the specific, but most estimates indicate that somewhere between 13% and 18% of current US construction jobs are currently being filled by undocumented labor. California itself relies on immigrant labor at a much higher rate than other areas in the country, and it is estimated that approximately 40% of the statewide construction labor force are immigrants. Due to factors alluded to above the precise degree of exposure to these policies for California construction labor remains unknown, it is reasonable to expect that federal initiatives will have the net impact of reducing a worker pool that was already insufficient relative to demand.





Distribution of undocumented labor sources is also not universal. While certain trades like elevator installers and electricians have much lower levels of undocumented participation, other trades like laborers, cement installers/finishers and roofers have much higher average levels of workers from these groups. Because of the nature/scope of Valley Water projects and the materials that are most prevalent in them, these changes represent an outsized risk for Valley Water and other major infrastructure owners.

Looking forward in the short term, we can confidently predict that competition for infrastructure specific general and subcontractors will remain relatively tight based on upcoming competing projects (detailed below), with large projects on the horizon set to continue through the early/middle 2030s as currently planned- though material delays and labor shortages are likely to result in project delays. In the medium to long term, we can anticipate a reversion to some of the construction environment and pressures noted in the 2008-2023 years, predicated largely on increased interest in data centers and artificial intelligence. Current projections for the greater San Francisco/San Jose area indicate that based on current trends power consumption is anticipated to more than double between 2024 and 2035- rising from roughly 700mW to over 1,400mW. Anecdotal evidence

supports this, with CBRE reporting lease activity on Data Centers in the greater Silicon Valley region nearly doubling in 2024 from 2023. Nascent interest on the part of the federal government in investing in AI at many levels, combined with the "goldrush" attitude being noticeably observed across most private sector industries, will continue to drive demand in this sector for the foreseeable future.

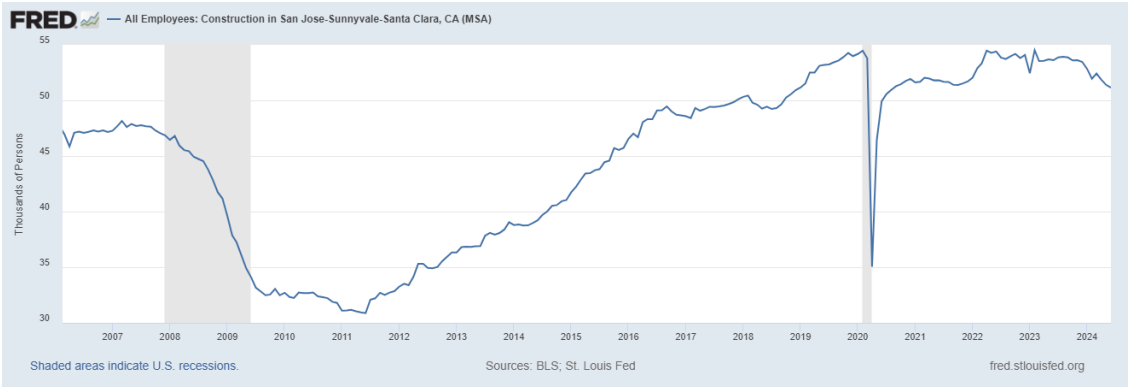
VALLEY WATER COMMUNITY BENEFIT

In addition to the direct benefits to local population provided by the substance of Valley Water projects in the form of new and/or increased utility service and safety, Valley Water projects also provide direct economic benefits to the community in the form of job creation. In order to assist in defining the total number of jobs created, we have taken Valley Water's planned design and construction expenditures over the life of their capital plan and, utilizing average hourly rates, extracted a total number of jobs provided in each sector for each year. In the case of design professionals, research into current average hourly rates for Bay Area designers of different specialties was solicited and averaged, to which we then added additional allowances for company overhead, profit, etc. We then used these rates and average number of hours equivalent to a full time position to determine the total value of a full time design position in the area, and divided the total funds set aside for design by these figures. Our methodology for the extraction of construction positions mirrored this closely with the exception of having pulled the current California Prevailing Wage statutes for the area for applicable positions utilized on Valley Water projects. Though these numbers are not exact, they do represent a reasonable extrapolation of the employment and economic benefits of SCVWD programs. Please see below for a table of positions created by Valley Water Capital Expenditures over the life of the program.

	2025 (Actual)	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041
Design/Planning	145	101	235	84	78	79	11	9	6	2	4	5	3	3	1	1	1
Environmental	78	106	295	98	94	82	13	10	6	1	4	5	0	3	0	0	0
Construction	935	1278	1464	2053	1737	2159	2638	2518	2471	2403	1776	1352	1265	70	127	134	131
Total Jobs Created	1159	1485	1993	2234	1909	2321	2663	2536	2482	2406	1785	1362	1268	77	128	135	132
2024-2025 Delta	-25	-160	-109	-120	-547	-458	240	14	489	700	131	150	1189	-60	-5	-5	41

LOCAL INTERVIEWS

Deceleration in the decline of total construction positions has been observed since our last report, with total construction positions declining by 500 over the period vs. 2000 from the period before. Continued shifts to public and infrastructure-based projects have been observed and are anticipated to persist, with shortages of operating engineers and heavy equipment potentially becoming acute in the last two (2) years of the decade. If and when private sector interest rate reductions are achieved it is anticipated that the sectors that have seen the smallest growth of late, namely specialty contractors, will begin see immediate growth. Should this occur concurrently with a multibillion-dollar, county wide infrastructure investment cycle the effects on local construction labor absorption are likely to be drastic.



LOCAL PROJECTS- VERTICAL CONSTRUCTION

Though overall private sector construction across the greater Northern California submarket has continued to see lackluster growth as a whole over the last 12 months, certain subsectors have seen a reinvigoration in current and future anticipated activity. The technology sector, which was the single largest contributor to the decline in office construction in the market over the last two (2) years, has seen significant growth in both current and future planned data centers in the area driven by expectations regarding the required computing power for artificial intelligence applications. This reversal has been stark, so much so that seven (7) of the top ten (10) largest vertical construction projects currently planned or underway are data center projects. This growth in specific technology project types is anticipated to be indicative of broad swaths of future demand dynamics wherein technology companies will eschew large, amenity driven office projects in favor of projects that can be more directly and immediately tied to revenue/customer service offerings.

With the notable exception of multifamily residential construction, which currently enjoys a robust pipeline of current and potential projects, most other vertical, private sector project subsectors are forecasted to continue to see declines in overall volume until interest rates become more favorable for building at profit. Nevertheless, total volume for the area remains considerable with over $6bil. in total vertical building projects either underway or in design/procurement- though it should be noted that of that total, approximately $1bil. is represented by projects in the design/procurement stages. This curve is further reflective of the reality that although the greater market continues to see vertical project starts, the pace and size of these opportunities is on the decline.

Santa Clara County Current Vertical Construction Projects

Project Name	Stage	Type	Valuation
Kaiser Permanente Medical Center - Utility Plant	Construction	Parking Garage/CUP	$658,673,731
SCVMC Behavioral Health Services Center	Construction	Hospital/Bridge	$388,376,000
Stack Trade Zone Park Data Center Expansion	Construction	Data Center/Office	$375,000,000
SVY03 Data Center 60 MW - Santa Clara CA	Construction	Data Center/Office	$300,000,000
Office/R&D/Manufacturing Buildings/Parking Garage	Construction	Office Campus	$295,000,000
Hangar One Restoration	Construction	Aircraft R&D	$200,000,000
Edgecore SV02 Data Center Building 2	Construction	Data Center	$170,000,000
Coresite SV9 Data Center	Construction	Data Center	$150,000,000
Edgecore SV01 Data Center 36 MW Bldg 1	Construction	Data Center	$150,000,000
Equinix Data Center SV-18	Construction	Data Center	$136,541,664

LOCAL PROJECTS- HORIZONTAL CONSTRUCTION

Standing in stark contrast to the vertical sector, the horizontal market in the Santa Clara County area has seen an astounding 5x growth in total current/future planned infrastructure over the last twelve (12) months- rising from $3bil. as of our last report to just under $15bil. as of the date of this report. Almost $9bil. of this is being driven by two projects including the $6.5bil. planned BART expansion and Valley Waters' upcoming renovation of the Pacheco Reservoir, but even if these were to be removed the area would have seen project volume in the horizontal sector double year over year from $3bil. to $6bil. It should also be noted that these totals almost certainly leave out both certain projects, as most of the Anderson Dam project isn't included in the total, and are reflective of now eclipsed project cost totals. This is to say that although the total volume for the sector is significant, it is likely in reality to be larger than is currently reported. In another reversal of the realities in the vertical sector, projects in the horizontal sector that are currently in construction total $2.7bil. while those still in development total approximately $12bil.- further indicating a need to plan for competition when procuring large infrastructure projects.

Santa Clara County Current Heavy Civil Construction Projects

Project Name	Stage	Type	Valuation
Diridon Station Redevelopment	Pre-Design	Railroad	$6,500,000,000
Pacheco Reservoir Expansion	Pre-Design	Water Treatment Plant	$1,996,000,000
Kaiser Permanente Medical Center - Utility Plant	Construction	Parking/Utilities	$658,673,731
Confidential Office	Construction	Heating/Cooling Plant	$295,000,000
BART Silicon Valley Ph II Ext Tunnel & Trackwork	Construction	Hazardous Abatement	$235,000,000
VA Palo Alto Utility Renovations	Pre-Design	Utilities	$225,000,000
Upper Guadalupe River I-280 to Blossom Hill	Pre-Design	Roads/Paving	$176,618,000
Anderson Dam Tunnel Project	Construction	Water Supply Water Line	$168,000,000
Digested Sludge Dewatering Facility Project	Construction	Sewage Treatment Plant	$164,000,000
Mary Avenue Extension	Construction	Roads/Paving	$163,000,000

EXPECTED FUTURE BIDDING CONDITIONS

From a bidding perspective, the lessening in frequency and magnitude of vertical construction opportunities should serve as positive influence on Valley Water construction priorities in the near and medium term. Of the two (2) large General Contractors surveyed for this report both reported lower than typical or desired backlog numbers (roughly 2/3 of typical levels), as well as that their project procurement teams were increasingly focusing on public projects, including utility and infrastructure, as a means for balancing out their medium-term planning. These same contractors shared that their subcontracting partners were similarly motivated, and that their average number of subcontractor bids on projects had increased significantly from last year to now (2 to 4-5 on average). This is anecdotally borne out across the entirety of the market as multiple AGC surveys point to an increasing flight to public and horizontal construction as a method of keeping crews active until vertical construction becomes a more attractive prospect for owners, and the same contractors surveyed both shared that they'd seen a considerable uptick in interest from peers in the same projects that they themselves were beginning to pursue.

Due to the size and complexity of Valley Water projects small contractors are not likely to often bid projects as a general contractor, and of those recently contacted most were reluctant to bid projects of that type. Reservations typically include insurance and bonding requirements, ability to successfully complete projects of that size/complexity, and the ability to maintain financial and project records that would comply with Valley Water standards and practices. There are different potential options that could somewhat ameliorate these reservations and encourage more bidding activity, including more intensive outreach to small and disadvantaged area contractors on smaller projects, the encouragement of mentor/mentee arrangements between large and small businesses, and increased requirements for small business participation on contracting teams. However, given both the constraints previously noted above and the reality that given constraints in economies of scale small businesses cannot generally price their projects at the same margins as their larger counterparts this path is not likely to be a significant driver of change in Valley Water value for money in terms of construction service procurements.

From a design perspective small and medium sized businesses will constitute a more viable vendor source, but these types of projects are not often the focus of smaller design studios and, as such, are not typically pursued. Small firms that are currently doing design work for Santa Clara public agencies, e.g. RRM Design Group, do not have experience in Valley Water's typical project types, nor the resources to acquire them, and as such do not pursue these types of opportunities no matter the size. This is potentially a conquerable challenge, though, as most design professionals spoken with did not have an accurate view of the total breadth and depth of the Valley Water project portfolio. A more concerted outreach to small and medium sized design groups, potentially through an industry day or similar event, with the goal of introducing them to smaller, more approachable Valley Water opportunities that would facilitate an eventual comfort level could, in the long term, produce a viable crop of these types of firms that are both capable of performing and willing to bid on future projects. Unlike purveyors of built services, the lack of requirement to purchase large amounts of external materials to provide services allows these firms to price their activities in line with their interest working on a particular job or with a particular client. Given that Valley Water is often a procurer of very large projects these firms, if they can be made to feel comfortable with their ability to perform, can and will price their efforts at or below their larger counterparts when they pursue.

LOCAL ESCALATION SUMMARY

The continued proliferation of projects that directly compete with Valley Water construction priorities, e.g. BART, along with current project delays, represent the most significant factor driving costs forward in the area over the short term. Shortages in trades prevalent in these projects have been noted for some time, but the acceleration of project development in the sector has exacerbated these longer-term issues and, combined with high levels of absorption in other parts of the state, are combining to create a potentially dramatic, short-term uptick in commanded wages. The reversal of the Federal Reserve's position on interest rates, which is anticipated to occur at some point in the next 12 months, will almost certainly serve to renew private sector interest in capital expenditures, which will remove the major factor serving to moderate volume to a level sufficient for labor to service it. As increasing investments into artificial intelligence come to fruition it is also anticipated that this will lead to large construction needs, both in terms of buildings/data centers and in terms of supporting infrastructure like electrical supply. Materials pricing, which had seen declines over most of 2024, has reversed and is once again trending near all-time highs- largely predicated on both real and perceived effects of federal trade/tariff policy. Current geopolitical conflicts in the Eastern European and Middle East have the capacity to exert major influence on domestic energy pricing and given the nature of Valley Water projects and their degree of utilization of heavy equipment these represent an additional risk item that bears monitoring. From an overall perspective, we predict a slight (.5%) increase in the projected Valley Water

escalation rates relative to expectations at this time last year, driven largely by increased concerns about labor availability and material price spikes.

ESCALATION OUTLOOK						
Year	***FY27***	***FY28***	***FY29***	***FY30***	***FY31***	***FY32-41***
Construction Cost Escalation Rate	5.25%	5.55%	5.85%	6.25%	5.75%	5.15%

LOCAL CONSTRUCTION WAGES

The San Jose/Santa Clara market, like its adjacent Bay Area counterparts and other metropolitan parts of the state, typically sees wage rates that well exceed national averages. It should be stressed, however, that these rates constitute a wage base more than an actual or "effective" wage rate, and that in times or areas where construction volume outstrips the ability of the surrounding population to staff it wage premiums become a necessary component in order to entice skilled workers in large numbers. Due to the presence of these conditions, published wage rates are often exceeded in the Santa Clara market.

These factors will be particularly salient over the balance of 2025 and through 2026 as area workers are lured to Los Angeles to assist with rebuilding from the Pacific Palisades fire earlier in the year, which is anticipated to raise wages by as much as 30% in the short term. Though this poses less of an issue due to the types of projects Valley Water procures and manages, it is still worth bearing in mind as one contemplates the likelihood of wage premiums in the near term.

Current Santa Clara County Construction Wages, Infrastructure

Trade	Wage	Fringe	Total
Ironworker	$55.33	$35.52	$90.85
Cement Mason	$47.00	$29.81	$76.81
Carpenter	$64.01	$35.01	$99.02
Laborer	$37.97	$29.91	$67.88
Operating Engineer (Heavy Highway)	$66.12	$33.50	$99.62
Operating Engineer (Pile Driver)	$66.12	$33.50	$99.62
Operating Engineer (Underground)	$62.62	$33.50	$96.12
Operating Engineer (Steel Fabrication)	$66.75	$33.50	$100.25
Electrician	$100.25	$47.46	$147.71
Chief Field Surveyor	$62.05	$34.53	$96.58
Plumber (Underground)	$34.51	$36.36	$70.87

RECENT TRENDS

US national material pricing post COVID has been, in a word, volatile. After seeing significant increases from 2020 through 2022, largely predicated on upward pressure on metals, concrete and MEP components, price increases began to stabilize in 2023 and, to a great extent, pushed sideways over the course of the next two years. Periodic increases in 2023 and 2024 have consistently regressed to the newly established mean, which at the end of 2024 was roughly 9% below the high reached at the end of 2022.

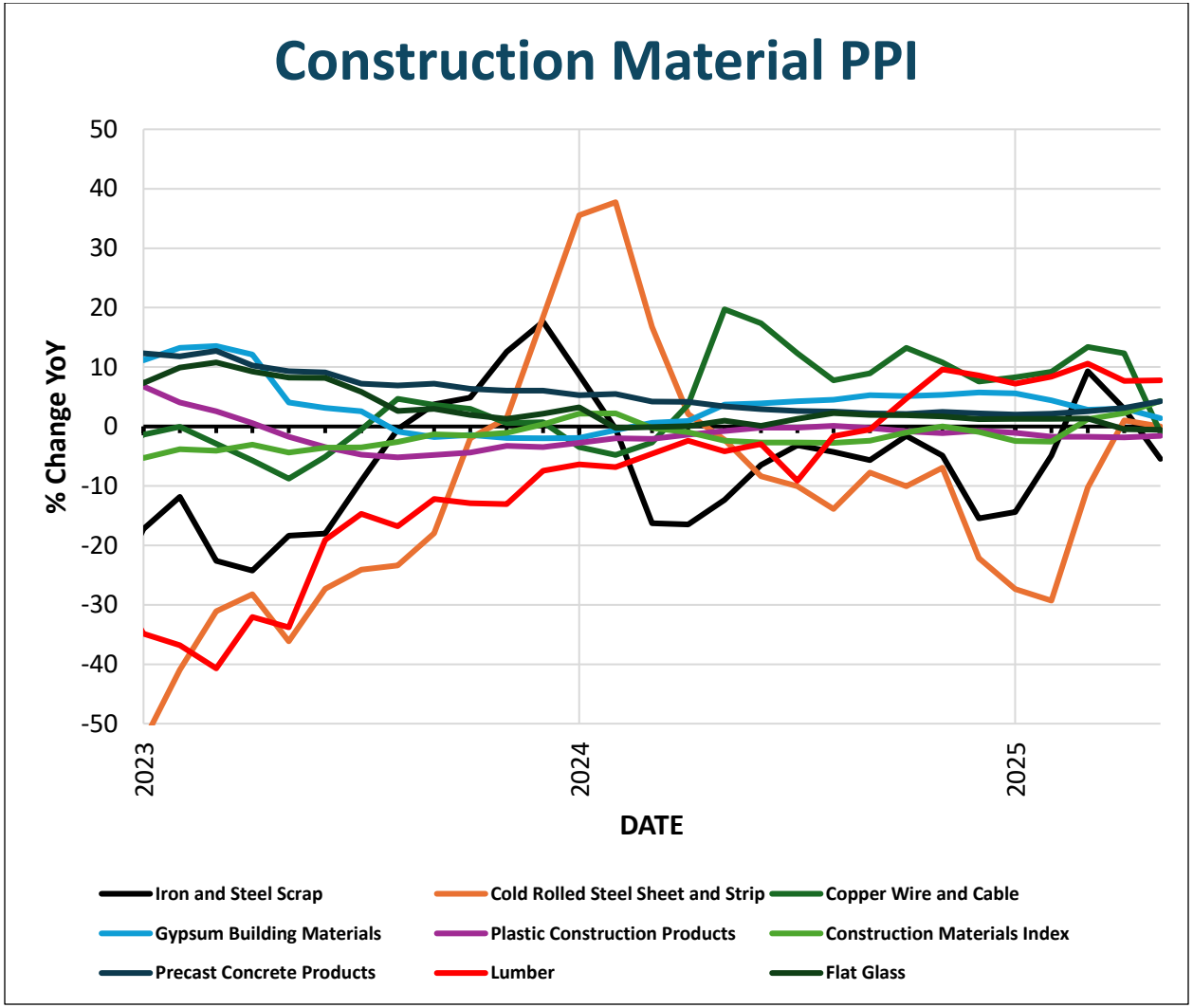
TARIFFS & VOLATILITY

2025, in contrast, has seen a resurgence in pricing increases, largely due to nascent federal trade-based policy decisions. Though future forecasted policy has yet to stabilize, the reintroduction of tariff policies at the start of the year have both given more power to domestic producers and decreased the confidence of the contracting and ownership communities, which has led to rapid increases in material absorption as project teams race to buy ahead of future perceived price increases. These conditions in tandem have correlated to a relatively large uptick in construction material costs since the beginning of the year, and increases year-to-date (YTD) have totaled 3%, or 30% of the total decrease from the peak in late 2022. Announcements in mid-May regarding suspensions of most of these policies have resulted in a temporary cooling of concerns about short term, substantial price increases, but nationwide the contracting community is still pricing a fair amount of risk into estimates and total project costs have, on average, increased roughly 3.5-5% YTD.

Share of US imports	Share of Imports	Total Proposed Tariff, June 2025
European Union	18.50%	20%
China	13.40%	55%
Japan	4.50%	24%
Vietnam	4.20%	46%
South Korea	4.00%	25%
Taiwan	3.60%	32%
India	2.70%	26%
UK	2.10%	10%
Switzerland	1.90%	10%
Thailand	1.90%	36%

Material PPI	1 Month	3 Months	12 Months	24 Months
Air Conditioning and Refrigeration Equipment	1.92%	2.65%	2.20%	4.92%
Machinery and Equipment: Motors, Generators	-0.12%	-0.06%	5.46%	9.77%
Cold Rolled Steel	9.39%	23.60%	0.84%	2.95%
Copper Wire and Cable	4.95%	11.84%	12.18%	16.29%
Iron and Steel Scrap	-7.86%	5.50%	3.00%	-13.98%
Flat Glass	-1.87%	-1.67%	-0.44%	-0.36%
Gypsum Products	-0.37%	0.44%	-5.85%	-2.23%
Precast Concrete	0.56%	1.65%	3.14%	7.39%
Ready-Mix Concrete	0.23%	-0.11%	1.66%	9.02%
Plastics Construction Products	0.58%	-0.60%	-1.87%	-3.20%

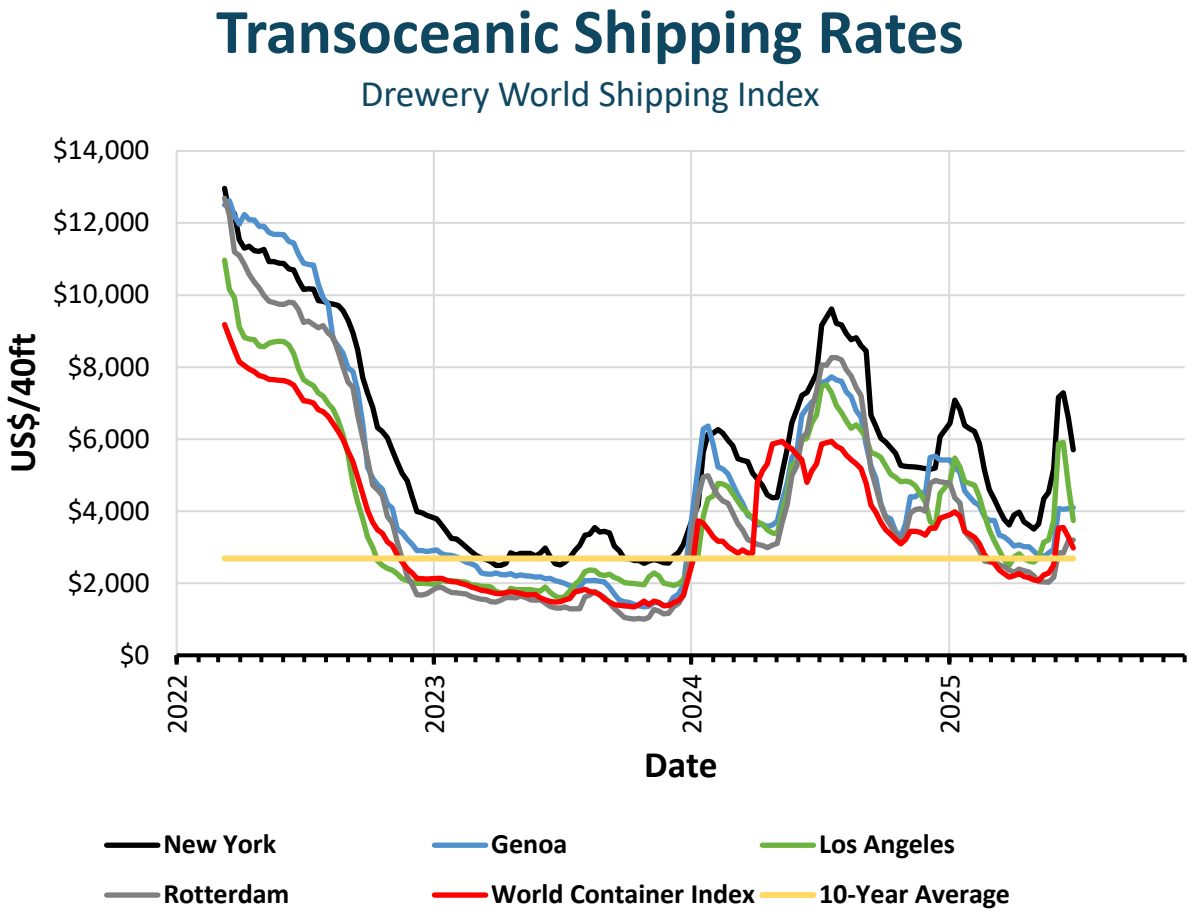
Looking forward, continued apprehension regarding US trade policy and the possibility for correlated disruptions to the supply chain is anticipated to continue to exert upward pressure on most materials, with particular emphasis on steel, lumber and MEP products. Reductions in federal sustainability initiatives may provide some relief within the mechanical, electrical and plumbing sectors, particularly in copper wire and other products associated with increased electrification efforts, but the reality of construction pricing is that it is as much based on perceptions of future conditions as it is on current facts and figures, and until a greater degree of confidence regarding the short and medium term policy environment can be had construction material premiums should be an expected component of market pricing. More narrow expectations for US tariff policy at the beginning of 2025 had translated to a roughly 4% increase in the total cost of construction projects to date as summarized by several large general contractors, but should trade policy be affected on a wider scale, which is to say beyond the initial targets discussed like Canada, Mexico and China to a more comprehensive strategy that affects relationships with all or most US trade partners, this premium is likely to become more pronounced.



SHIPPING COSTS

International shipping costs, which played a significant role in the growth of construction pricing during COVID, have seen a tremendous decline in the intervening period. The rate to ship a 40' container, which is the benchmark rate for shipping costs, swung from under $2,000/each in 2020 to just over $12,000/each by 2022 before beginning to decline. This increase was predicated on a number of factors including shortages of port personnel, fuel cost increases and a lack of sufficient boats in the water to accommodate demand. Several of these predicated costs have declined in the years since, however, and this has led to a noticeable decrease in shipping costs. Energy and fuel costs, which saw marked increases during COVID, have been in decline since 2023 and show no signs of reversal – and in fact are likely to continue to see decline in the next two (2) fiscal years. The number of boats in the water, according to WorldPorts.org, has increased by almost 10% over the same period, which has translated to a growth of almost 1.5M 40' container berths. These factors in tandem help to explain the downward trend of shipping costs, which, in the US, are currently sitting at roughly $2,900/each.

It should be noted that current pricing (see red line for World Index) includes an almost 38% spike in costs in since March in response to rising costs and risks associated with conflict in the middle east. These have declined in the wake of temporary easing of tensions. Should conflict re-ignite in the region, it would be prudent to expect a reversion to the upward trend previewed between March and June.



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