# Whitestone Report

**Facility Funding Targets are Distorted by Price Changes**

*Recent declines in costs have mixed implications for the facility management industry. Two Whitestone indices turned negative in February, the most current data available. Maintenance and repair (M&R) costs declined 4.7 percent, year over year, the first time we have seen a real decline since the inception of the index in 1994. Overall, real estate operating costs declined by 1.5 percent.*

Normally, declining costs are viewed as a positive occurrence: limited resources can be stretched farther than planned. But when future funding is based on simple ratios that do not fully incorporate cost changes, either up or down, then budgets can be distorted.

For example, maintenance and repair costs for large facility portfolios are often expressed as a simple ratio of plant replacement value (PRV). A frequently cited guideline for M&R is two percent of PRV. According to the Whitestone commercial and institutional construction cost index, construction costs (a reasonable proxy for PRV) increased 1.8 percent over the past year. So according to the ratio, M&R cost last year were $2.00 per hundred dollars of replacement value, rising with construction costs to $2.04 this year and $2.07 next year, assuming the same rate of increase.

However, actual M&R costs have been declining by 4.7 percent, and using this rate results in a budget estimate in sharp contrast to the replacement value ratio; assuming $2.00 was the correct M&R rate last year, it is $1.91 this year and $1.82 the next.

The analysis showed that the second alternative was the lower cost alternative—12 percent less than life cycle costs for the current building configuration and 16 percent than alternative 1—despite the higher initial cost. The rankings were robust, even when evaluated using the shorter investment period (25 years) and lower discount rate (2.6 percent) usually used for non-energy projects.

In other words, if current cost trends continue, the simple PRV ratio would overstate the actual costs by over 14 percent ($2.07 / $1.82) within just 2 years. Our conclusion is that budgets based on PRV ratios—a common practice among some federal agencies—are inherently wrong unless M&R costs and new construction costs change at exactly the same rate. The same problem exists for any facility funding benchmark expressed as a percentage of PRV.

A PDF copy of ths report is available online at http://www.whitestoneresearch.com/reports/20090423.htm. To learn more, contact Whitestone Research at contact@whitestoneresearch.com.

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