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BUILDERS CAREFULLY WATCH ECONOMIC TRENDS AND CONSTRUCTION COSTS

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Since the beginning of 2008, leaders in commercial construction have monitored the financial markets, economic reports, the single-family residential market and commercial lending activity with keen interest. Most reporting agencies and economists now report that the U.S. economy is either near or already in a recession, a marked contrast to the consensus at the end of 2007. The unemployment rate continued to climb in March 2008 for the third consecutive month, an indicator for many economists that a national recession has arrived.

The commercial construction market also appears to be entering a period of diminished activity, and uncertainty is emerging with construction material costs and labor. Last year, overall non-residential construction activity was high in nearly every segment of the market and across most of the country. Labor availability improved last year and labor costs were moderate, below the previous high marks reached in 2004 through 2006.

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The robust growth of 13% that was experienced in the commercial construction industry in 2007 was preceded by a healthy 8.4% increase in 2006 as compared to only .5% growth in 2005. A report by the U.S. Census Bureau (www.census.gov/constructionspending) indicated that 15 of the 16 non-residential categories of construction that are measured by the Bureau rose in 2007. The only exception was in religious facilities, a category of construction closely tied to residential construction.

Growth Markets

The Associated General Contractors of America's Chief Economist, Ken Simonson, has predicted that although many markets will not reach the growth realized in the past two years, certain market areas will continue to grow in 2008 and beyond. The five markets that appear poised for another year of strong spending and growth include: power, energy, communication, hospital and higher education. Construction activity within these market segments will affect both materials and labor utilized in other sectors as well. Let's take a closer look at the anticipated growth markets.

Power – Over the past few years, the nation has become much more focused on power generation, power consumption and power conservation. Construction growth within this sector – comprised of power plants, wind and solar facilities and transmission lines – grew by 27% in 2007. The U.S. Census construction spending outlook report predicts a similar gain in this sector in 2008.

Energy – In order to maximize yields in the oil and gas production industry, refiners have announced major expansions and additions to existing plants and retrofits that also address

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environmental concerns. Due to the size and scope of these projects, construction assignments are often multi-year in duration, securing a healthy outlook for this type of commercial construction activity. It is predicted that this segment will enjoy a 20% increase in activity in 2008.

Communication – The continued growth in use of cell phones and personal digital assistants have caused a furor of activity in constructing new cell phone towers and data centers to support the increasing load of data and video files. The construction of "server farms" or data centers requires heavy-duty electrical, cooling and security systems. This market sector grew over 21% in 2007 and is anticipated to repeat this growth rate in 2008.

Hospitals – Medical centers and hospitals have been forced to consider significant retrofitting as well as new construction to keep up with technological changes in the way that medical services are delivered and patients are treated. New diagnostic technologies require new power, plumbing and air handling systems to function within optimum conditions. The trend to convert semi-private rooms to private rooms continues, and changes in environmental and severe-weather protection standards have increased construction levels even further. As population areas expand, growth in new hospital construction rose 16% in 2007 with an equal growth rate anticipated in 2008.

Higher Education – Overall, educational construction numbers rose by 14% in 2007 with the strongest category of construction occurring in private higher education, at 25%. It is anticipated that this level of activity within the higher education arena will likely continue through 2008 since these projects tend to be of large scale and significant duration. However, any appreciable

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reduction in property tax collections and other revenue sources that fund construction could pose a slowdown in the public higher education market at the end of 2008.

Material Costs Forecast

Over the past four years, price increases for construction materials have risen faster than the consumer price index. From December 2003 to January 2008, construction prices have increased 30.2% compared to a 14.5% increase in the consumer price index. Each market segment of construction relies upon a different mix of materials to build within that sector. Such diverse mixes of materials have explained why costs for different construction sectors have diverged in recent years. Some materials are used exclusively or primarily in construction while other materials are found in a wide range of manufacturing uses. Some materials can be produced locally or within the region while others are impacted by their production or use within the global market.

The most severe price increases have been directly felt in three major areas: diesel fuel, copper wire and pipe, and steel products – each heavily utilized within commercial and industrial construction.

Diesel Fuel – Within the first two months of 2008, retail prices of diesel were 40% higher than the same period in 2007. Since December 2003, the price of diesel fuel has risen 186%, the highest of any construction component. From January 2007 to January 2008, a 55% increase was noted following the negligible price increase of 2.3% that was enjoyed in 2006.

Steel – Since the first half of 2004, the price of steel has soared 63%, although considerable

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variations across product lines were realized. Over that timeframe, sheet metal rose 24% while steel pipe and tube jumped 81%. In early 2008, price increases by U.S. steel mills were being driven by both manufacturing cost increases and opportunity. It is anticipated that overall steel prices will rise 5% in 2008.

Copper – Copper is widely used in wire, piping, roof flashing, electric and electronic components and brass fixtures. At the end of February 2008, the price of copper on the New York Mercantile Exchange was more than $3.80 per pound, a 40% increase since February of 2007. Notwithstanding this significant increase, an additional 10% price spike is anticipated in 2008.

It is anticipated that 2008 will see construction cost increases ranging from 6% to 8%. Even though the current slowdown in the U.S. economy will generate more aggressive pricing from suppliers and subcontractors domestically, many construction components such as diesel fuel, steel and copper are in demand around the globe placing upward pressure on prices and availability. In addition, the commercial construction market is heavily dependent upon the delivery of heavy, bulky, relatively low-value materials with expensive transportation costs. Growing transportation bottlenecks and rising fuel costs will have a greater impact on the construction market than on most other industries. It appears that this range of increased prices should be incorporated into current and future construction budgets to avoid unexpected cost surprises that may either delay or forestall the launch of a new project.

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