

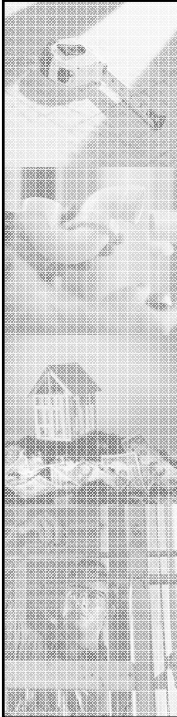


 **Leland Saylor Associates**
A Certified DVBE

Market Trends

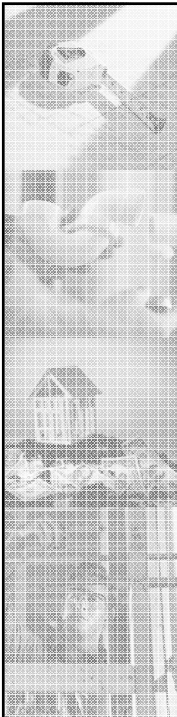
2007

 **Sierra West Group**
Program Management & Construction Consulting



HISTORY

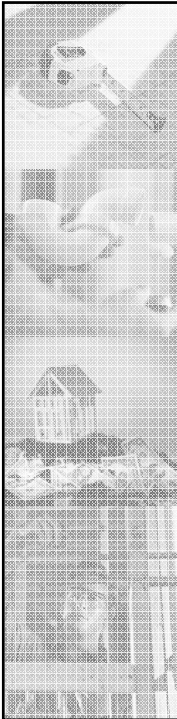
- The moderate inflation rates experienced by the construction industry for much of 1990 and through 2003 may go down in economic textbooks as a fluke made possible by the rare combination of cheap imports, energy and money combined with a relatively weak global economy. Those conditions are changing.” *Tim Grogan, ENR – Fourth Quarterly Cost Report*



CURRENT CALIFORNIA CONSTRUCTION MARKET

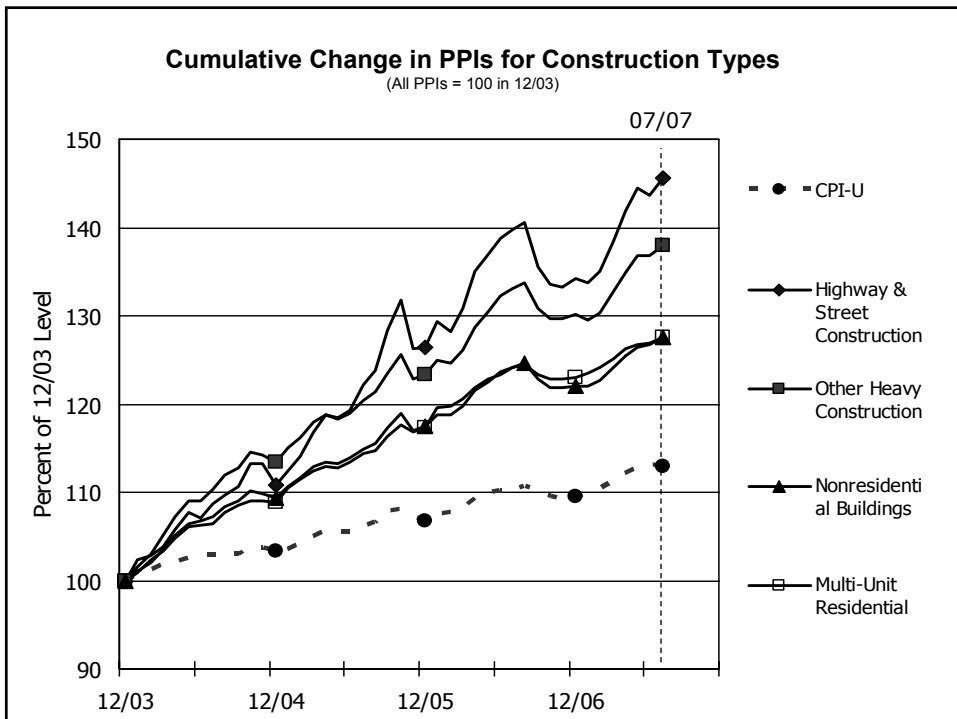
SUPPLY AND DEMAND *(is alive and well in California)*

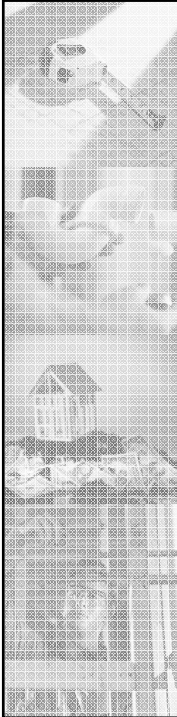
- \$25 Billion in Hospital work – AB1954 - Seismic
 - \$55 Billion in construction bonds in the State of California in the past 5 years for schools, prisons, jails, libraries, courts, infrastructure, etc. California approved a package of infrastructure bonds in the amount of \$37.3 billion—
 - 1. Bond 1A --Transportation, Air Quality and Security: \$19.9725 billion.
 - 2. Bond 1B --Housing: \$2.85 billion
 - 3. Bond 1C --Flood Protection: \$4.09 billion
 - 4. Bond 1D --Education: \$10.416 billion
- (These are in addition to the local school and community college bonds which were also passed throughout the State.)*
- \$1 Billion PG&E transmission line in Central Valley PLUS largest photovoltaic farm in the world being built in the Central Valley
 - New gas, co-generation, WWTP, etc throughout California



WHY

- Early 2000's the global demand was not anticipated as the USA became a part of the global economy and had to share world resources with other countries, this combined with all the economic issues already taking place in USA created the "perfect storm" .
- In 2004-05 --28% increase in construction starts.
- By 2006 the construction industry had corrected and overblown itself with record inflation rates.





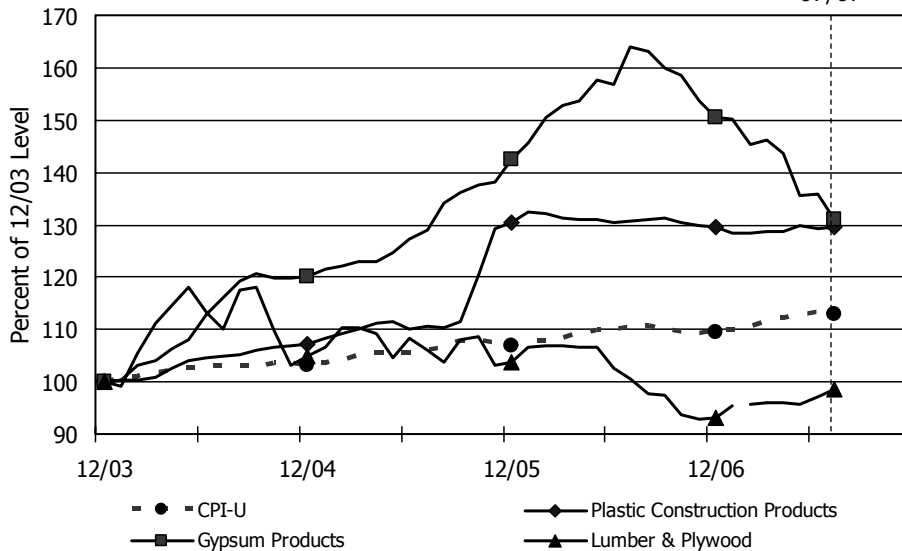
CEMENT

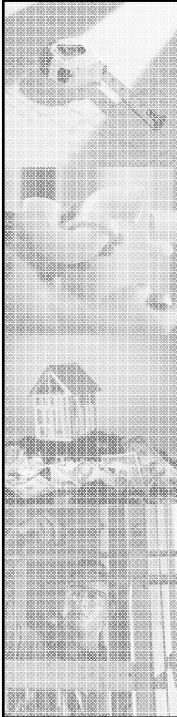
- **Housing Expected to Drag Down 2007 Cement Consumption** – “ The on-going correction in residential construction is expected to drag down overall 2007 construction activity. According to the most recent forecast from the Economic Research department at Portland Cement Association (PCA), despite a record 18% growth since 2003, cement consumption this year is projected to decline by 1.5%.” However, the cost of shipping
- However, cement from across the ocean (25% of US supply) is high, because the same ships that carry cement are in demand for hauling scrap metals, ores and other commodities.

Cumulative Change in PPIs for Selected Building Inputs

(Courtesy of Ken Simonson, AGC)
(All PPIs = 100 in 12/03)

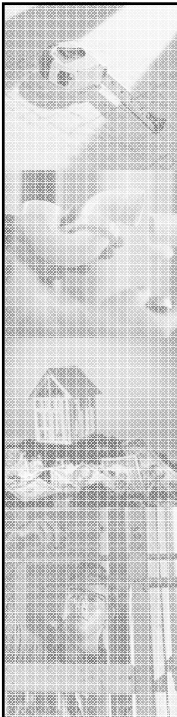
07/07





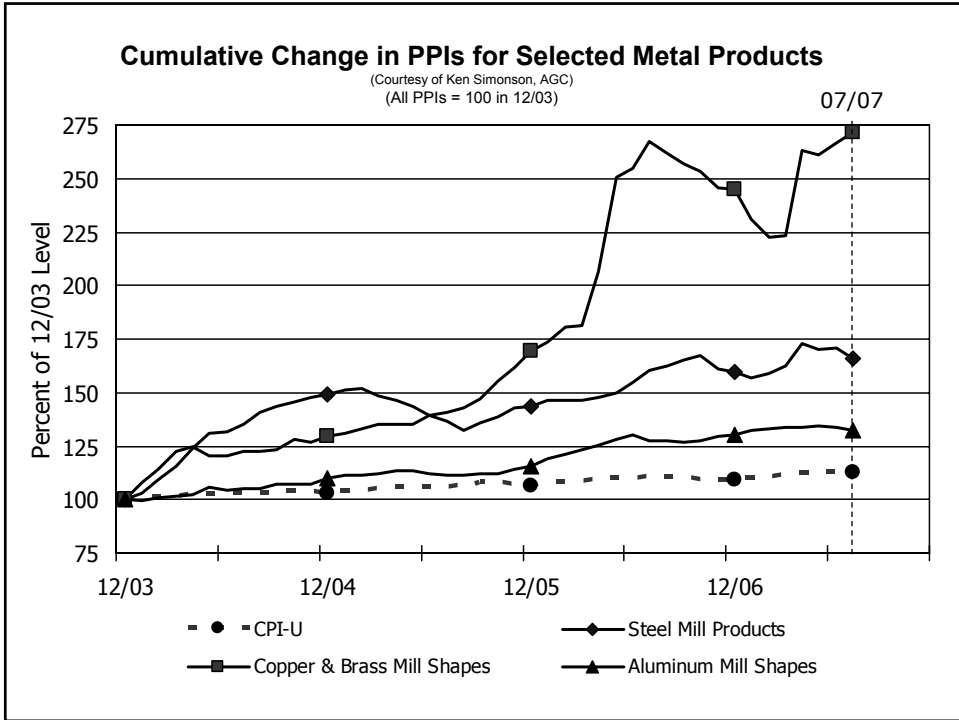
MATERIALS OIL

- Oil prices have been one of the most volatile commodities with prices reaching an all time high of \$80 a barrel this past week
- *Contractors pay, directly or indirectly, for the large amounts of diesel fuel used for site work and infrastructure, i.e. excavating, earthmoving and other off-road work. This includes operating concrete mixers, dump trucks and other vehicles; and for deliveries of equipment and materials and hauling away dirt, debris and equipment.*
- 42% increase in construction starts in heavy engineering in 2005-06



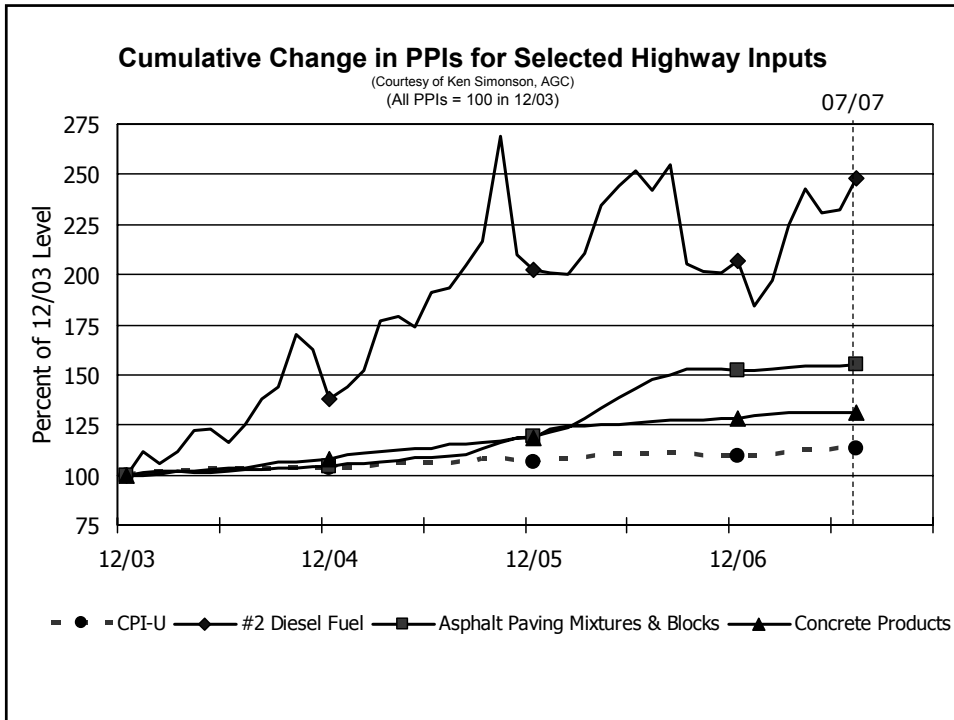
MATERIALS-- STEEL, METALS

“The consensus in commodity markets is that iron ore prices will increase about 20% in the next year. Alone, this would add about 5% to the price of high volume, inexpensive grades of steel but less to the prices of alloy, custom finish or custom shape products.” *Jim Haughey, August 7, 2007, Reed Construction Data*



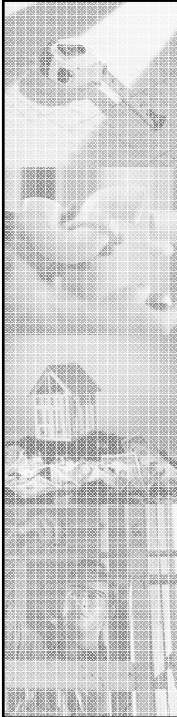
MATERIALS - INFRASTRUCTURE

- The infrastructure costs and highway construction costs have risen so much because key materials for roads and paving have risen in addition, heavy engineering work has risen 16% over this period last year – Reed Construction Data



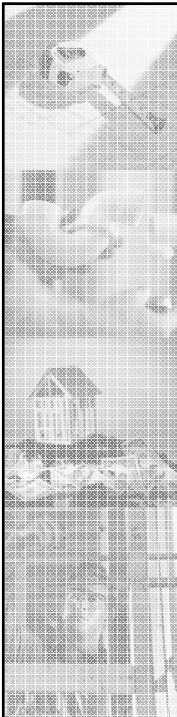
MARKET TRENDS

- 2007 - 2nd Quarter of the LSI Index,
 - the labor and materials showed a 5.7% increase from the previous 12 months (due primarily to increased labor contracts) and 1.5% from the first of the year (Jan 2007) and .9% increase from the 2nd quarter of 2007.
 - The “in-place costs” showed a lesser rate of increases averaging a 4.3% from the previous 12-month period and 1.3% increase from the first of the year (Jan 2007) and .01% for the 2nd quarter of 2007.



LABOR: INCREASED COSTS FOR 2007

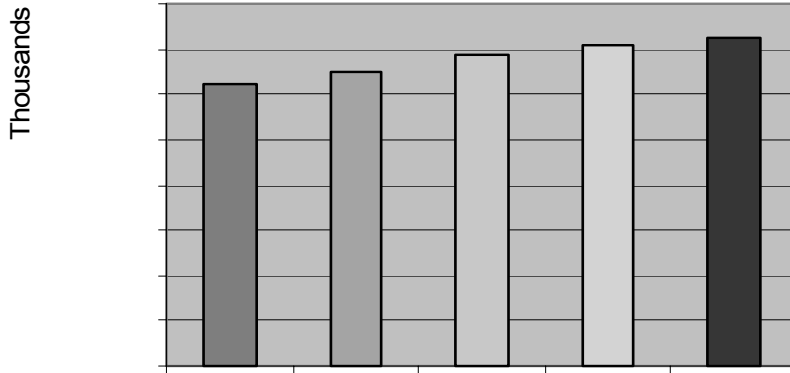
- Employment declining while wages rising
- Shortage of skilled workers
 - Current demographic trends show more skilled workers retiring than enter the industry
 - Growing specialization of labor: residential vs. non-residential
 - Workers displaced from the residential industry not easily retrained for commercial & institutional work
 - In the short-term, more skilled workers can command higher wages. Shortages abound in :
 - Commercial sheet metal, Mechanical, Electrical
- Benefits, especially health care, continue to increase at double-digit rates
- California leads the nation in wage hikes in 2006:
 - San Francisco (Common labor, 8.9%), Los Angeles (Skilled labor, 9.9%)



FACTORS INFLUENCING LABOR ESCALATION

- Recent recession(2001-2003) drove out excess subcontract capacity
- Skilled workers moved to other markets or out of the trades entirely, some never to return
- Costs other than salaries escalated at more than three times the rate of the CPI (benefits, insurance)
- Recession hiring practices kept payrolls low and diverted money from training new workers
- To produce new journeyman workers takes between two & four years.

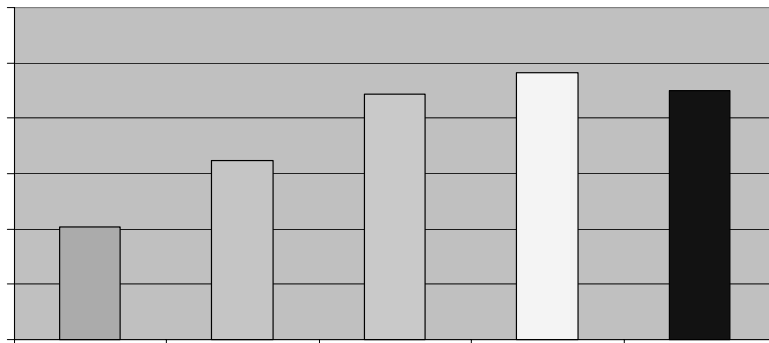
CALIFORNIA EMPLOYMENT INCREASE 2003-2007



Total Increase 2003-2007: 6%

CALIFORNIA CONSTRUCTION EMPLOYMENT INCREASE 2003-2007

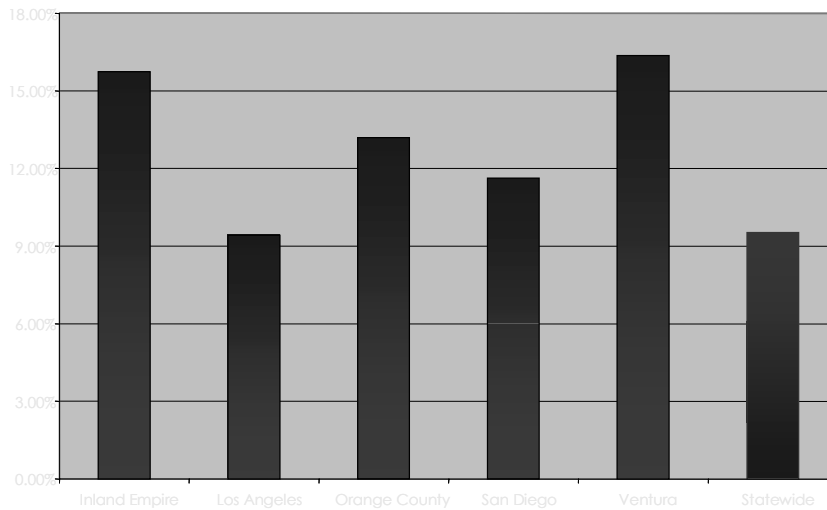
California Construction Employment Increase



Total Increase 2003-2007: 14%

EMPLOYMENT – ORANGE COUNTY

Construction Employment Change by County, 4/04-3/06



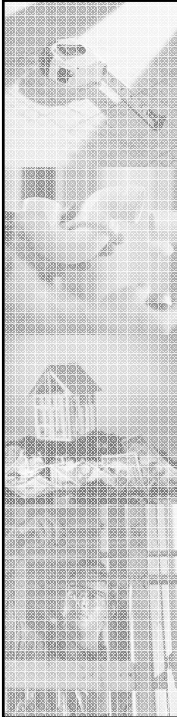
LACK OF SKILLED WORKERS DRIVES RECORD WAGE HIKES

- California leads the nation in wage hikes:

- San Francisco, common labor, 8.9%
- Los Angeles, skilled labor, 9.9%

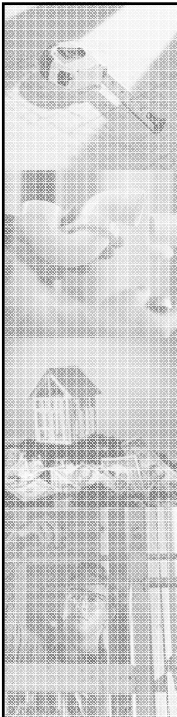
Overall, all trades increasing at record levels:

- 2004, 4.3%
- 2005, 4.5%
- 2006, 4.7%



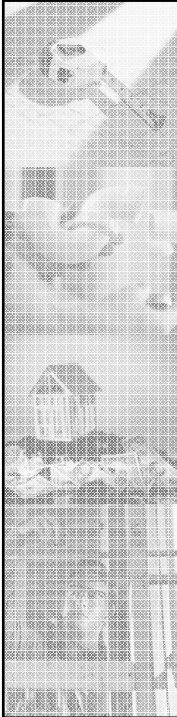
COMPETITIVE BIDDING

- As a general rule, estimators expect that their estimates will fall between +5% and -5% if the normal 5 to 6 bids are received
- Many projects in 2005-2006 received 1, 2, or 3 bids, causing severe budget overruns.
- In 2007, smaller projects were garnering more bids (often 4 or 5) while large projects are still getting limited competition



PRICE DIFFERENTIAL WITHOUT COMPETITIVE BIDDING

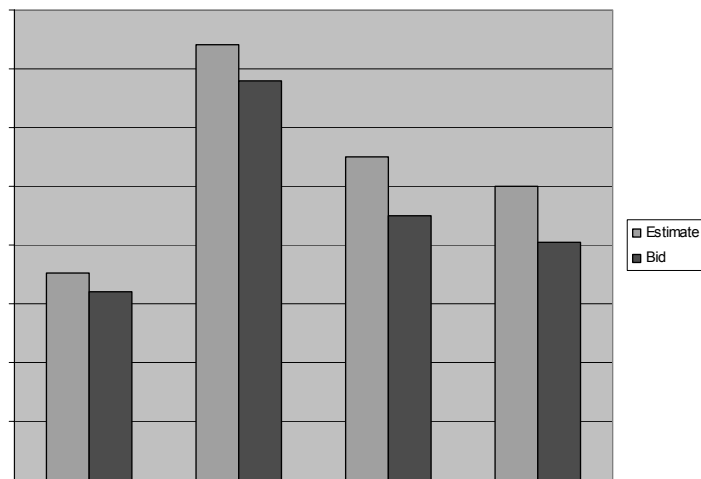
- | Number of Bids | % Differential |
|----------------|----------------|
| • 1 bid | +25% to 50% |
| • 2-3 bids | +10% to 25% |
| • 4-5 bids | 0% to +10% |
| • 6-7 bids | 0% to -10% |



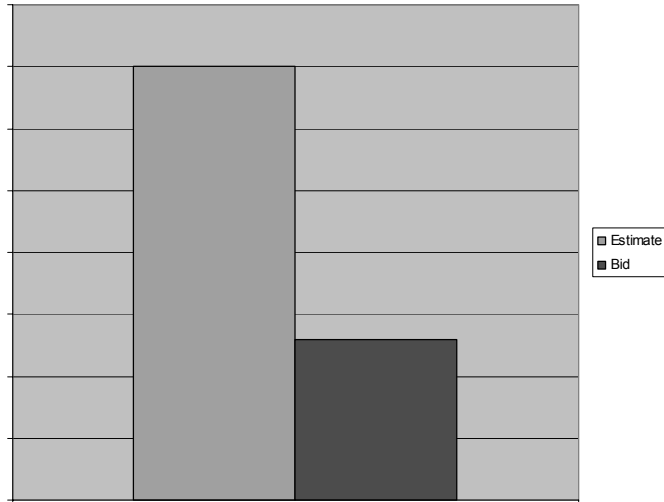
A TALE OF TWO BIDS

- Two V.A. Home projects
 - Similar scope, same architect, same owner, same project delivery process, bid one week apart:
 - V.A. Home West Los Angeles, 370,000 GSF
 - Only two bidders, 11% over estimate
 - V.A. Home Lancaster, 46,000 GSF
 - Four bidders, 4.7% under estimate
 - Larger projects still getting limited bids due to reduced bonding capacity and lack of subs who can take on large work

BIDS SUMMER 2007

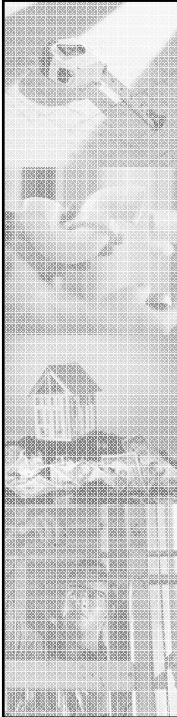


MARKET SHOWING SOME IMPROVEMENT OVER \$50 MM



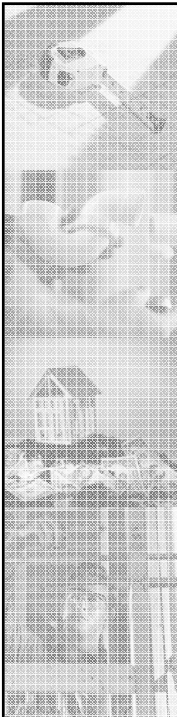
FACTORS INFLUENCING # OF BIDS

- Size
 - Projects \$50 MM+ rarely receive more than 1 or 2 bids
- Project Labor Agreements/Local Hiring
- Complex or unusual structure
- Addenda issued after bid advertisement
- Phasing/occupied facilities
- Multiple and/or complex alternates
- Owner reputation/processes/payment policies
- Non-standard bid form



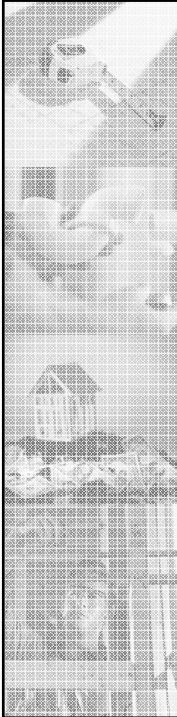
MITIGATION TECHNIQUES BIDDING PHASE

- Work with Owner to identify likely bidding pool
- Identify, and possibly eliminate, any barriers that would make it more difficult to bid project
- Solicit contractor interest at least 2-3 months before bid
- Allow 2 months for bidding cycle
- Prequalification is not recommended at this time



COST ADVISORY 1ST QUARTER 2007

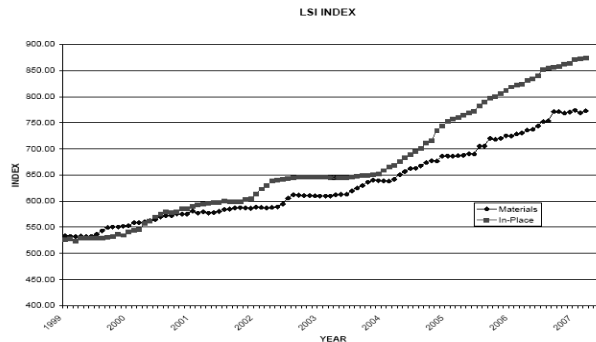
- ***Construction in California is not slowing down and prices are not coming down.***
- ***However - Has California reached, or is it close to reaching capacity for construction?***

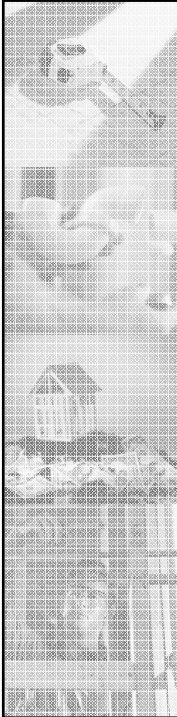


COST ADVISORY 1ST QUARTER 2007

- Projections of building starts – 2007-2008
 - “*Spending peaked early in 2006, then declined ...based on activity levels through August 2006, Reed Construction Data (RCD) now expects total U.S. construction activity to increase +5.2% in both 2006 and 2007 versus +10.5% in 2005. (Both 2006 and 2007 have been revised downward from RCD’s previous forecast.)*”
CONSTRUCTION FORECASTS U.S. Jim Haughey -- October 23, 2006
 - “*It is only a matter of time before the housing begins to recover from its first major down turn in about 15 years...*” **Housing Expected to Improve as the Year Progresses, News Release, NAHB, Feb 14, 2007.**

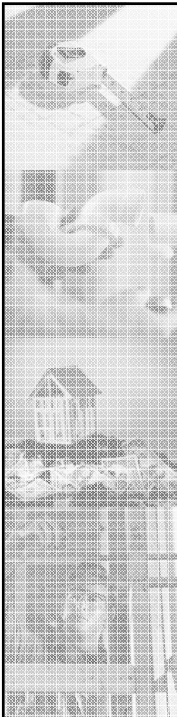
LSI Index





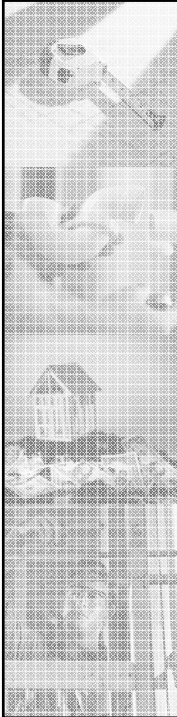
OVERHEAD FACTORS

- Standard overhead costs
 - Worker's Compensation
 - Mandated Health Insurance
 - Extended offices at job site
 - Tightening Bonds
 - Profit



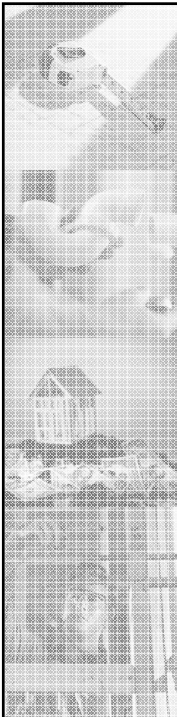
UNFUNDED MANDATES

In the United States, anytime the State, County or City gets involved in the regulation process, especially in construction, the trades, and even air quality, it ends up costing money.



UNFUNDED MANDATES

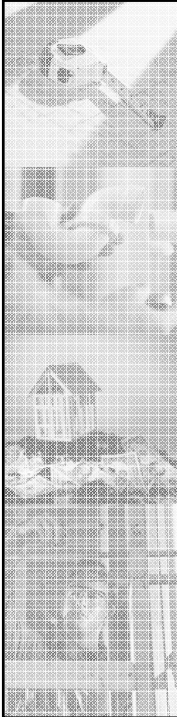
- CARB – (California Air Resources Board)
- SWPPP – (Storm Water Pollution Prevention Plan)
- LABOR COMPLIANCE
- NEW IMMIGRATION LAWS
- CAL-OSHA REQUIREMENTS
- LABOR AGREEMENTS – (Project Labor Agreements)



OTHER FACTORS

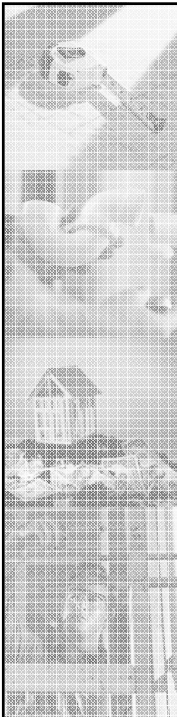
- Construction requires physical delivery of materials.
“A perfect storm in shipping will make for an ugly 2008.
Expect big bottlenecks and price hikes similar to 2004 and 2005, when a surge in imports overwhelmed truckers and made firms wait weeks.
...
- Worker shortages will affect sea- and airports, trucking firms, and railroads. Federal rules requiring background checks for employees are set to take effect next year, and many applicants won't pass. Trucking firms, which rely heavily on immigrants, may be hit hardest.”

Reed Construction Data



MARKET TRENDS & PROJECTIONS

- Materials are in worldwide demand, with uncertain supply growth (e.g. copper, oil)
- No material shortages (except in some markets for stainless steel, asphalt and concrete)
- Labor rates are up an average of 4.1%,
- Bids are coming in from 15% to 25% **under** budget estimates on projects under \$20 Million.
- Uncertainty in the financial markets – NOT lack of work (*California just passed another \$39 Bil in bonds for everything under the sun*).
- Abundance of contractors/subcontractors bidding projects..



2007-2008 PROJECTIONS

- Sierra West Group is predicting an annual inflation rate of 5- 5 ½% for the year 2007 with an increase next spring to double that – 8 ½ - 9% in 2008.