

Sierra West Group

Program Management & Construction Consulting

Editor: Mary E. Wallers,

May 2005 ---Vol 1

CONSTRUCTION FOCUS **NEWSLETTER**

WHAT DID HAPPEN IN 2004?

Sierra West Group (SWG) is a firm of construction cost consultant specialists providing independent, unbiased, expert advice on all matters of construction cost and time. The Sacramento based offices of The Sierra West Group has been actively involved in both public and private sector projects throughout California and the Pacific Northwest since 1990.

We offer a full range of cost planning and cost control services to allow our clients to proceed with certainty that once a realistic project budget has been set, it can be maintained to project completion.

Mary Wallers is the editor and publisher of the **LSI Index**, (formerly known as the *Lee Saylor Index*) which is the only recognized inflationary index for the west coast, and is published in the **Engineering News Record**. The Index is considered one of the eleven most important construction indices in the United States. She is also an Associate Editor on the **Saylor Construction Cost Manual**, which is in its 41st year of publication.

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LSI Index 12/31/04 -- has shown a dramatic increase in the material pricing alone - 10.1%, and not just in California. However, the dramatic escalations in overall "in-place" building costs are primarily shown in California. *Building indexes are to furnish a yardstick for measuring the historical fluctuations in construction costs - not a "glass ball" to tell us the future.*

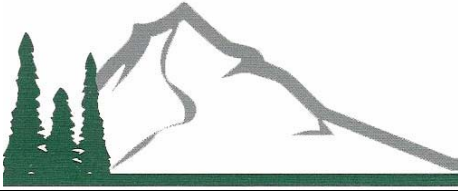
There were increases in construction costs and materials which set records. According to Ed Sullivan, Chief Economist of the Portland Cement Assn, "in retrospect, the 2004 market represented a year of transition for the U.S. construction market".

At the Start of 2004, some believed the construction industry's "smooth sailing" outlook for the coming years was too good to be true. Their caution was apparently warranted.

"Higher oil and energy prices will slow overall economic activity in 2005, delaying recovery in nonresidential and public construction..." **2005 US Cement Forecast Jan 1, 2005, Cement Americas.com**".

"The moderate inflation rates experienced by the construction industry for much of the 1990 have and through 2003 may go down in economic text books 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**

"The Perfect Storm" (which is attached) explains somewhat the various impacts on the current steel situation worldwide. Summarized, it says emphatically, we are no longer in a national economy -the United



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States is participating in a global economy. And this is being reiterated over and over by contractors, owners and architects. (Attached)

Associated General Contractors of America (AGC) commented on the value of construction in place. The preliminary full year total for 2004 was \$998 Billion, a 9% increase for 2003 – “after falling for three years, private nonresidential construction would be up 4% higher than in the previous year, with December’s total a solid 6% higher than in December 2003. ...Public construction 3% higher for the full year and 9% ahead in December.”

The continuing low mortgage rates will prolong the residential construction and inflation will run stronger, consumer spending will be partially compromised, job gains will be small and expectations on both the consumer side and the business side will be lower.

The main issues which have occurred in the global construction market in 2004 which have impacted the US construction market has been

(1) The international construction spending growth exceeded 4.6% and is projected to exceed 5% a year growth for each of the next four years. **ENR, 1/31/2005;** and

(2)...*the emergence of China as an economic powerhouse has shaken up global supply and demand, pushing up commodity prices and skewing international freight costs.* **2005 US Cement Forecast-Jan 1, 2005, Cement Americas.com**

We also know the State of California had just passed \$12 Billion in education bonds this past year. In addition there was the remaining work resulting from

the ongoing construction remaining on numerous other state bonds passed in previous years, and the work resulting from numerous local entities; school

districts and community college bonds which had also been passed. Californians have also approved major bonding for infrastructure in recent years.

Supply and Demand - is alive and well. We have found the predominant issue in the rise in construction costs is still the number of projects being bid in California, which does has started to show some slowing, but is still very high.

SOME PEOPLE ARE saying “The shock of steel prices has psychologically shaken everyone; a lot of owners are just starting to accept higher prices.”

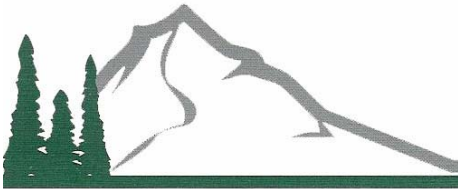
... they are seeing bids come in 20% to 30% over budget and that only about 5% of that increase can be attributed to higher material prices.

One school contractor was heard bragging that he priced a job and then added another \$1 Million and got the job...

To really bring this into focus, consider the number of projects in the period January 2003 to Jun 2003 was 185; in Jul 2003 to Dec 2003, the number of projects over \$5 Million was 235 – The entire year 2003 was equal to the first three quarters of 2004.

ENR is forecasting that annual inflation will slip back to 3.5% in 2005 after increasing 9.7% this year.

According to the Federal Reserve Board “Beige Book” Report of March 9, 2005, Labor markets strengthened in almost all Districts, while wages continued to increase at a moderate pace, employers in many Districts reported on going pressures from higher benefit costs.



KEY MATERIALS

Basic materials have increased from January 2004 with an overall average price increase of 14%. We have seen shortages, which have caused long lead times, along with price increases in several key construction materials since the first of the year.

Oil--With diesel and gasoline are hitting an all time high, *the oil prices are also affecting the asphalt, pvc pipe, conduit, etc.*

Delivery of materials and supplies are still going up with the ever-increasing fuel and energy costs.--and predicted to go to \$3.00 per gallon with the next year.

Structural steel prices to peak at \$628 per ton in the first quarter of 2005 and then slide back. - 2003 4th quarter @ \$358/ton

Rebar prices falling from \$530 per ton to \$418 in the last quarter - 2003 - \$316/ton

Lumber - 43% gain in 2005 - with reducing the Canadian 27% tariff on wood products, should have a decline in costs of about 20%

4-ply pine plywood will decline 26/% next year after increasing 20% in 2004 and 36% in 2003.

OSB prices - 84% increase - projected 34% decrease in 2005

ENR - cement prices this year increased 6%. However, the price of imported cement, which accounts for 25% of the market, jumped 12.6%. - rising cost of ocean freight and lack of availability spurred import prices. Projected another 4% increase in 2005.

Concrete - delays to 30 days - demand high, shortages, and 15 - 20% price increases - no allotment guarantees on projects over 24 months out.

Lumber - Starting to soften, but up 25% in in-place prices.

Energy --Gas and Oil prices are still increasing and should hit \$3.00 per gallon by the end of the year, before they stop. Oil prices have risen to record levels at \$55 per barrel and are still rising. This means asphalt, plastics, pvc piping, is very much impacted by these increases.

Steel --The price of steel has soared over the past year. Steel is one of the key materials that when it increases it will impact almost every division in construction, from the foundation with rebar to the electrical conduit.

OUTSIDE FACTORS

Labor

Labor costs have increased since over the year with the new labor contracts and increases in overhead issues. Skilled labor is still one of the main problems.

The Sacramento Regional Research Institute (SRRRI) shows a modest gain of 31,900 new jobs in construction in 2003-2004. The journeymen levels in the trades have not grown according to membership reports for the local unions.

Insurances

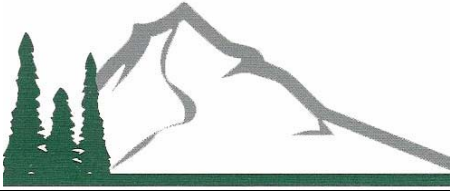
The worker's compensation insurance issue has not gone away, while a drop in rates was anticipated, they were not the cuts promised, and only a few contractors saw any adjustments. Workmen's compensation insurance that had seen increases of 30+percentage per year for several years and was given a 7% decrease and a 3 ½% increase by CIRB

for additional regulations added by the legislature.

In addition to the worker's compensation problems, contractor's bonding and liability insurance rose dramatically, almost doubling for some small contractors and taking them out of the public sector.

Regulations

When the State Legislature gets involved in regulating the trades, it costs money. Examples of these types of rules are: All electrical connections must be made by a journeyman electrician. Another of the issues is the law requiring registration and certification of electrical journeyman. .



THE PERFECT STORM

- China demand (1/3 of total world capacity)
- Weak dollar
- Soaring ocean freight cost
- Raw material shortages (*Cement, Steel, Copper, Gypsum, Lumber, Oil*)
- Global scrap selling
- Domestic recovery (demand increase)
- Domestic mill consolidation over past three years
- Dramatic increase in California Construction Activity
- Freight and fuel surcharges
- Increasing overhead costs (*Bonds, Insurance and Worker's Comp premiums*)
- Increased Energy Costs
- Projected increases, but at a more moderate rate than the first half of the year.