



KILEYADVISORS

2010

**Greater Houston Construction
Market Forecast**



This report was produced by Kiley Advisors LLC and
The Associated General Contractors – Houston Chapter

2010

Cloudy with a Chance of Clearing

U.S. AND GLOBAL ECONOMIES

Many signs point to an improved economy and gradual recovery:

- ❖ U.S. leading indicators are up 1.1% in December--the 9th month of continued positive readings.
- ❖ U.S. unemployment claims are declining; as are net job losses
- ❖ U.S. manufacturing production is experiencing growth.
- ❖ The U.S. continues to have population and workforce growth and productivity gains.
- ❖ U.S. Residential building permits are up 15% from 2008, adding to the 3rd quarter GDP for the first time since 2005.
- ❖ 4th quarter GDP estimated growth is 5.7%, and predicted 2010 average GDP growth will be around 2.5%, reflecting improvement over 2009.

However, other facts create ongoing concerns:

- ❖ Mortgage delinquencies remain at high levels.
- ❖ Home sales are still weak, although helped somewhat in 2010 by Federal incentives. The latest report on sales of new single-family homes shows a 23% drop from 2008.
- ❖ Interest rates will probably increase, dampening the uptick in home sales, particularly for first-time buyers.
- ❖ Commercial Real estate is a depressed market, and may get worse due to the amount of short-term debt.
- ❖ Financial markets (banks, venture capital) are still on “shaky ground” -- proposed regulations may create more issues, and additional bank failures are likely this year.
- ❖ An aging population will create higher health care costs, a smaller workforce and a loss of workforce experience/knowledge.

Global recovery forecast is mixed:

The International Monetary Fund (IMF) expects 2010 global growth of 3.9 percent, and 2011 growth of 4.3 percent. The BRIC alliance continues to lead:

- ❖ Brazil's projected GDP growth in 2010 is 4%
- ❖ Russia's economy has some problems, but may see at least 1% growth.
- ❖ India may have inflation woes, but has projected GDP growth of 6.5% at present.
- ❖ China will continue to grow – perhaps becoming the World's 2nd largest economy in 2010 with a projected GDP growth of 8.5% or more.
- ❖ In total, all emerging markets will contribute to world-wide economic growth with projected GDP of 4-5%.

Some long-term forecasts include further weakening of the U.S. dollar (a benefit for Houston's exports), more frequent recessionary periods over the next few decades, and interest rate increases world-wide.

In the U.S., the latest McGraw Hill reports on construction starts add little encouragement for 2010's building industry. Non-residential building starts were flat in December, and fell 33% in 2009. Residential building was down 31% for the year, although it edged up slightly (1%) in December. Non-building construction (highways, bridges, sewers, utilities, etc.) was down 9% for the year, but did show improvement with a 15% increase in December. According to Robert Murray, vice president of economic affairs for McGraw Hill, the overall 26% annual decline for construction starts in 2009 was the steepest we have seen in the past 40 years.

The quarterly survey of 75 corporate economists released by the National Association for Business Economics recently found a small net increase in demand at their firms in the fourth quarter and slightly more optimistic forecasts for corporate pricing, capital investment and hiring and economic growth. Some were predicting hiring again, and some were projecting spending on structures.

HOUSTON ECONOMY - Seeing signs of improvement

In December 2009, the Houston Purchasing Managers Index posted its *ninth consecutive month of improvement* and its *third consecutive month of signaling production growth in the near future*. The PMI is a short-term leading indicator for regional production. Readings above 50 indicate that production gains are on tap in three or four months; readings below 50 indicate that contraction is likely. December's index represents *a vast improvement from the record low 39.0 in March '09*. Large gains in the sales and production components were key contributors to the December advance. The employment component was the weakest.

Houston Purchasing Managers Index

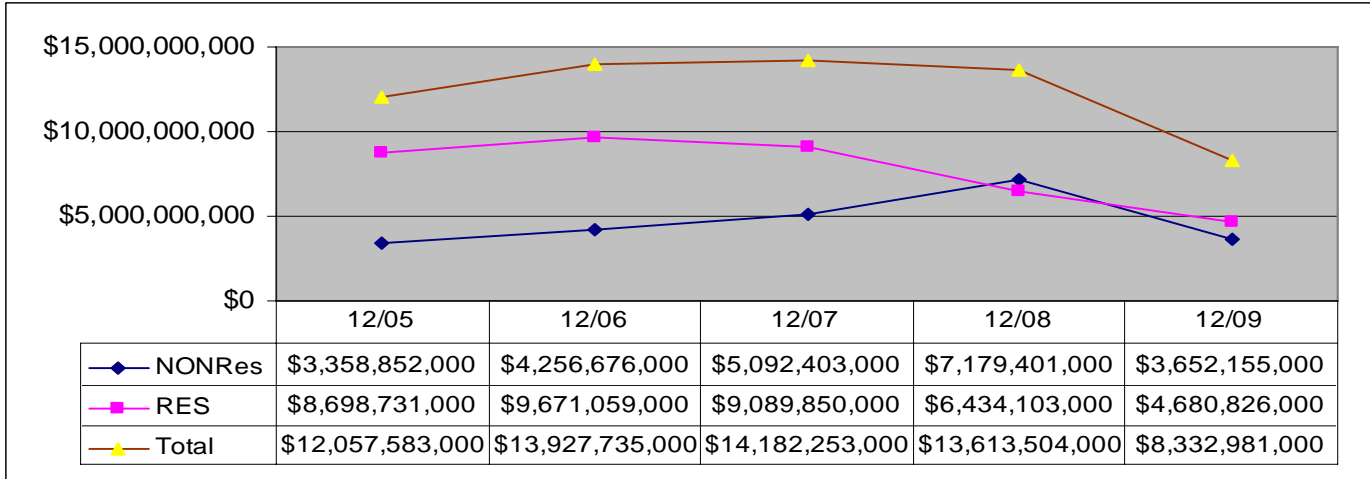
December 09	51.9	Highest reading since August '08
December 08	45.4	

2009: RESIDENTIAL/NON-RESIDENTIAL CONSTRUCTION

McGraw Hill Contracts Houston MSA – a strong decline

	<u>12/09</u>	<u>12/08</u>	<u>% change</u>
Non-Residential	\$3.65 B	7.2 B	- 49%
Residential	\$4.7 B	6.4 B	- 27%
Total	\$8.3 B	13.6 B	- 39%

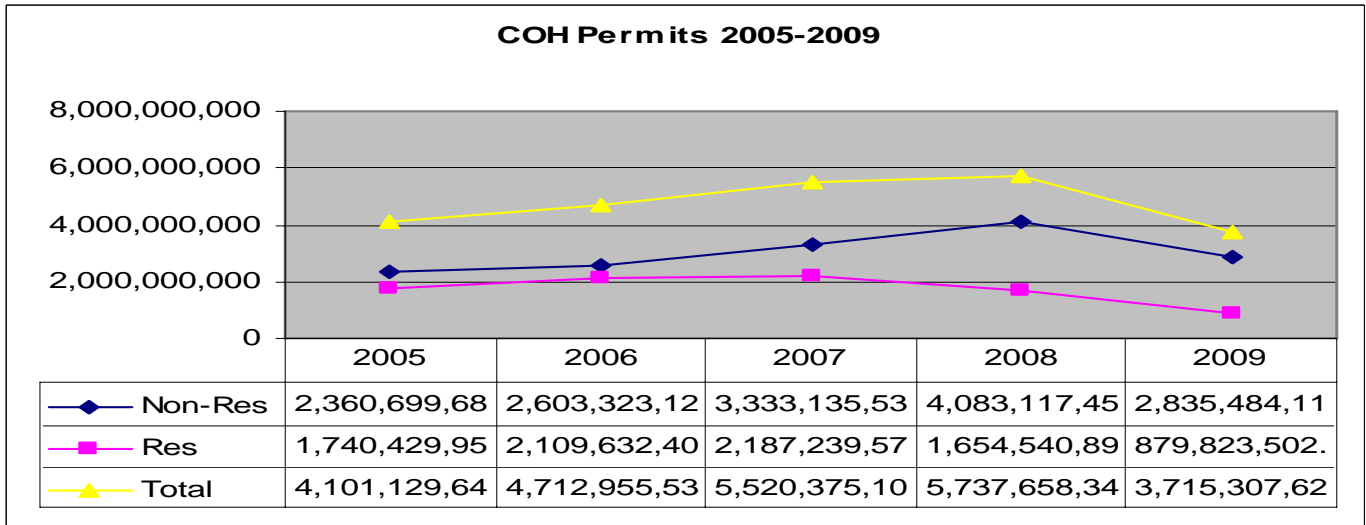
\$ Value of Contracts: 2005 – 2009



City Of Houston Building Permits – down significantly

	<u>12/09</u>	<u>12/08</u>	<u>% change</u>
Non-Residential	\$2.8 B	\$4.1 B	-30.6%
Residential	\$ 880 M	\$1.65 B	-46.8%
Total	\$3.7 B	\$5.7 B	-35.2%

\$ Value of Permits: 2005-2009



2009 EMPLOYMENT: HOUSTON – TEXAS – U.S.

Houston’s spectacular job growth in 2008 was shattered by a job loss of 92,500 in 2009 (this number may be higher once the annual March revisions are published); making it the worst labor market performance since the 1980’s.

The December unemployment rate in the Houston-Sugar Land-Baytown MSA rose to 8.3%--up from 5.6% in December, 2008.

Employment Job Losses through December 2009

Construction	- 25,500 (12.5% - one in 8 jobs)
Manufacturing	- 19,100 (approx 8%)
Architect/Engineering Services	- 5,600 (8.3%)

Job Growth did occur in: Health Care & Social Assistance, Educational Services, and Government Services

The Texas unemployment rate rose to 8% in December (vs. 5.7% in 2008), after 23,900 nonagricultural jobs were lost during the month.

The U.S. unemployment rate was unchanged in December at 9.7%.

2010 Construction Activity Drivers in Houston

Employment Growth:

The picture is improving. Job losses have begun to decline since August; most sectors that continue to lose jobs (construction, retail, and finance) are doing so at slower rates. Job growth is projected to begin in the 3rd quarter, and the Greater Houston Partnership projects a net gain of about 1,900 jobs in 2010. Meaningful job growth may not occur until 2011.

There are encouraging signs that the U.S. 4-week average job loss will decline to that “magic number” that represents “normal” job loss. Some economists suggest a 4-week average job loss of 400,000 is the number to look for; others suggest 350,000 - 375,000. However, *job growth* is needed for business expansion.

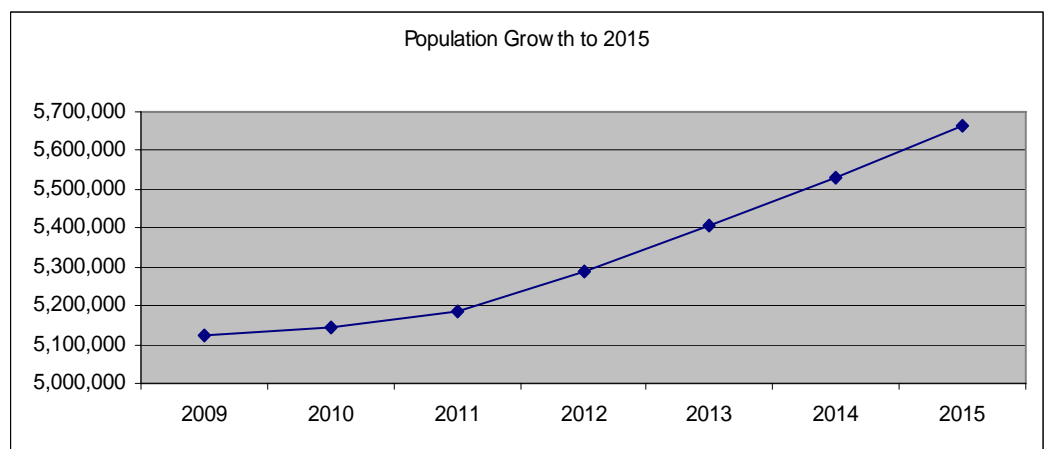
Population Growth

Houston is expected to continue growing.

HOUSTON PMSA

		<u>% Population Increase/year</u>	<u>#</u>
2009	5,123,157	.93%	47,242
2010	5,143,682	.40%	20,525
2011	5,187,148	.85%	43,466
2012	5,290,004	1.98%	102,856
2013	5,408,582	2.24%	118,578
2014	5,530,665	2.26%	122,083
2015	5,663,799	2.41%	133,134

Note: Slower population growth in 2010 and 2011, then healthy growth of over 100,000 in years 2012-2015. Long-range forecast 2010-2015 shows average gain of 104,000/year.



Vacancy, Rental & Absorption Rates

All of these numbers are negative in 2009 compared to 2008. Improvement in some sectors may occur in the latter part of 2010, but the office market will probably take longer to recover – sublease space is at very high levels. The industrial sector fares best with a vacancy rate at 6.8%, compared to the double-digit vacancy rates of other sectors (e.g., Office vacancy at 16%). Landlords and owners are providing concessions and rental rate reductions to keep valued tenants.

Architect Hiring

With commercial construction activity far below 2007-2008 levels, Houston architecture firms began to have layoffs in 2009, with more expected in 2010.

The National Architecture Billing Index (ABI) showed a negligible increase in December billings. According to Kermit Baker, AIA Economist, “There are continuing reports of viable projects awaiting financing -- the main impediment to an economic turnaround for the design and construction industry remains frozen credit markets.”

Billings:

Nov 09: 42.8
Dec 09: 43.4

Inquiries:

58.5
55.3

Regional Dec 09

Northeast: 48.6
Midwest: 46.6
South: 43.2
West: 40.0

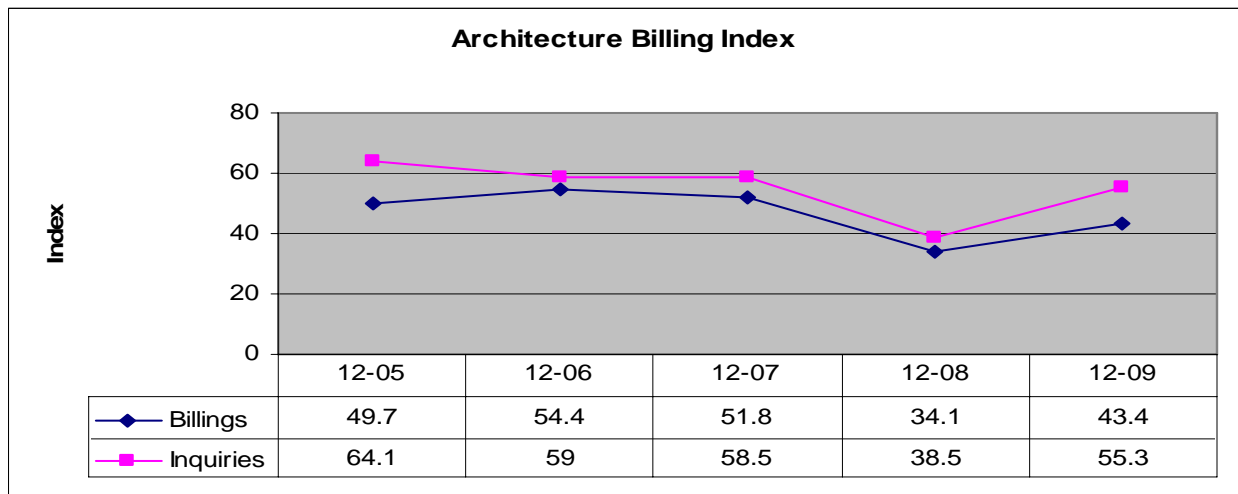
Up from 47.5
Up from 45.5
Down from 45.1 (Houston is in this region)
Down from 41.0

Sectors Dec 09

Residential
Commercial/Industrial
Institutional
Mixed

51.0 Up from Nov. 49.5
42.7 Down from Nov. 43.4
44.2 Down from Nov. 45.3
38.1 Down from Nov. 40.2

While commercial/industrial, institutional and mixed sectors are down, one positive sign is the increase in residential index above 50. Leading indicators point to a possible recovery in the latter half of 2010 for other sectors if this holds up.



Funding for Projects

A recent article in ENR Magazine stated: “The decline in construction activity this year was broader, steeper and faster than many economists anticipated, as private non-residential building markets succumbed to the credit crunch and many public markets wait for stimulus funding to be delivered.”

There are few financing options. Houston banks continue to have virtually prohibitive conditions in terms of up-front equity amounts, personal guarantee requirements, and restrictive loan covenants.

The large institutions have an active short-term preferred auction market, although it is riskier and more expensive than in the past. Also, school districts are once again able to sell bonds.

Energy Prices

The expansion of China’s economy, along with other Asian countries, will bring about a rise in energy prices in 2010 and 2011.

The EIA (Energy Information Administration) projects West Texas Intermediate Crude oil (WTI) to average \$80 per barrel in 2010 and up to \$84.00 per barrel in 2011, based on a U.S. GDP growth rates of 2% and 2.7% respectively.

Diesel prices will be affected by the increase in crude oil prices – with retail prices projected to average \$2.98 in 2010 and \$3.14 in 2011.

The Natural Gas Henry Hub spot price is projected at \$5.36/mcf in 2010 and \$6.12/mcf average in 2011.

Energy Sector End of Year Comparisons (12/31/09)

	2009	2008	% change
Avg. U.S. Rotary Rig Count	1,089	1,879	- 42%
Avg. Spot Crude Oil Price (WTI)	\$62.08	\$99.99	- 37.9%
Avg. Spot Natural Gas Price (HH)	\$ 3.90	\$ 8.81	- 55.7%

Exports:

A weak dollar helps to support Houston’s exports and is good news for the Port of Houston and Intercontinental Airport. While the dollar has been showing signs of strength lately, IHS Global Insight projects the dollar is on a “downward glide” path for 2010, particularly against emerging-market currencies.

SECTOR ANALYSIS

RESIDENTIAL

New single-family home sales in Houston fell 22.9% in 2009 compared to 2008.

Some suggest we are in for better times; while the market will be relatively flat, this sector is showing signs of life. However, some pressure exists on improvement given tight credit and weak job growth.

Optimism comes from extension of the federal housing tax credit, low mortgage rates, and projections of employment growth by the latter part of this year. Home price declines and low inventories are also good signs for increasing sales.

Nationally, building permits have already risen, and Houston’s new home starts are predicted to incrementally increase as well. New home starts increased in the 4th quarter of 2009 over the 4th quarter of 2008. For 2010, there will be 18,000-20,000 single family units built, according to Metrostudy.

MULTI-FAMILY

Multi-Family Housing (CBRE)

	4th Q 09	4th Q 08
Occupancy	84.3%	86.3%
Average Rental Rate	\$0.82/sq ft.	\$0.84/sq ft.
Absorption	(-2,206)	10,663 net units
Under Construction	3,215	11,752 units

With negative absorption in 2009, occupancy at 84.3%, and more units under construction, this will not be a “builders’ market” in 2010. A major developer recently announced they have put two major developments on hold. However, home foreclosures, employment and population growth could cause some of the Multi-Family vacancy to be absorbed.

HIGHWAY/CIVIL/ MUNICIPAL/UTILITY

This continues to be a very solid sector. Here is a breakdown:

TxDOT

TxDOT’s five counties will produce \$550 Million in construction for 2010. A key project is the Grand Parkway project. In addition, stimulus funding will help other projects get underway.

METRO and Others

METRO Solutions has \$498 Million planned in light rail projects. Also, the Port of Houston Authority recently received \$98 million in Federal stimulus funding to dredge the Ship Channel.

City of Houston

The City has projected nearly \$470 Million in civil work for 2010 – the majority of the projects relating to Street and Traffic Control.

Department	Amount	Big Projects
Street & Traffic Control	233.9 M	Right of Way & Fleet Mgmt. Facility (\$31.6M)
Water Utility System Facilities	74.3 M	Various projects/improvements & compliance
Wastewater Treatment Facilities	112.7 M	Northside sewer tunnel rehab (\$7M) Kirby Dr. Drainage Improvements (\$13.5M)
Storm Drainage System	46.9 M	Braes Blvd./Academy Storm Drainage (9.5M)
Total	\$467.8 Million	

Harris County

Harris County will have \$192 Million in Highway projects in 2010.

HEAVY INDUSTRIAL

Planned construction in the U.S. Southwest Market region (Texas, Oklahoma, Arkansas and Louisiana) includes 1,700 major industrial projects planned to begin construction in 2009 and 2010, with a total investment value of \$89 billion for capital projects and maintenance shutdown work. Two-thirds will be in Texas (900 projects/\$60 billion). The industry sectors that are most important to Houston are Oil & Gas, Power, Petroleum Refining and Chemicals. The highest share of North American spending in the Petroleum Refining and Chemical Processing industries are in the southwest market region.

In the Power Industry, Wind Power spending constitutes the largest portion of total spending. In Texas, developers added more than twice as much wind power as any other state last year, according to the latest report from the American Wind Energy Association. The Industrial Manufacturing sector will benefit from the production of turbines, towers and blades.

Continued environmental project spending by state and federal governments, development of renewable energy, an improving U.S. economy, and global growth will contribute to industrial spending. Concerns over new environmental regulations may impact project starts in some sectors.

COMMERCIAL & LIGHT INDUSTRIAL

THE PRIVATE MARKETS

General Purpose Office Space

Dark clouds hover over the 2010 Office market in 2010. Houston's office vacancy is nearly at 16% and there was 1 million square feet of negative absorption in the 4th quarter; total negative absorption of 2.4 million sq ft for 2009.

Lease rates at the end of 2009 were up compared to December 2008; however, rates began to decline in the 3rd quarter of 2009 for the first time since 2005.

OFFICE MARKET – 4th Q 2009 (CBRE)

	<u>4th Q 09</u>	<u>4th Q 08</u>
Vacancy	15.9%	Up from 11.9%
Lease rates	\$24.00	Up from \$23.57
Net Absorption (1M sq ft)		Down from 980K
Annual Absorption	-2.74M sq ft	Positive absorption +2.7M sq ft
Under Construction	2.4 M sq ft	7.7M sq ft

Delivered end of 2009: .5 M sq ft
2.5M sq ft remains in the pipeline through 2011.

Sublease space increased to 4.4M sq ft, reaching highest levels since the 80's.

Skanska has announced the development of a 14-story, 300,000 sq ft. office building in the Galleria area, which may start by year-end. There is a proposed technology park in Montgomery County near the Lone Star Executive Airport and there are also three other developments on hold that may move forward should conditions improve. In addition, "build-to-suits" are likely to take shape for clients with strong financial positions who realize that construction costs are extremely favorable right now.

Light Industrial/Warehouse/Service Center

Houston's industrial market fares better than most of the country, with a recent uptick in activity. It is still considerably stable, with the 2009 end of year vacancy rate remaining near historic lows. However, 2010 will be questionable in terms of new construction due to the financial market impact on all areas of construction, and some landlords have begun offering rent concessions. Most of the "spec market" is gone. Employment growth, trade, and energy-related growth drives this market. Here again, there will be some "build-to-suits."

2009 ended as follows:

INDUSTRIAL/WAREHOUSE MARKET – 4th Q 2009 (CBRE)

	<u>4th Q 09</u>	<u>4th Q 08</u>
Vacancy:	6.8%	6.3%
Lease Rates	\$0.48	\$0.54
Net Absorption:	848,000 sq ft	(284,000)
Annual Absorption	180,211 sq ft	4.5M sq ft net absorption
Under Construction	1.3 M sq ft	3.4 M sq ft
Delivered Construction	5.7M sq ft	12.3M sq ft (less than half of 2008)

Hotel/Motel

The U.S. hotel market is suffering with the rest of the commercial sectors in this economy. The U.S. Average Daily room rate fell about 8.8% in 2009, and is projected to fall another 1.5% in 2010. Occupancy rates were approximately 55% in 2009 and are forecasted at 55.2% in 2010 – two of the lowest levels of occupancy since this data reporting began in 1988. *Lodging Econometrics* recently reported that “just 717 hotels, representing 82,620 rooms, will open in 2010. This is a 56% drop from 2009. Project cancellations and postponements remain at historical highs, and new project announcements have fallen to five-year lows.”

However, Houston fared better than the overall nation in 2009:

HOTEL INDUSTRY – Houston (PKF)
YTD THROUGH NOVEMBER 2009

	2009	2008	% change
Avg. Occupancy:	60.5%	70.6%	- 10.1%
Avg. Daily Rate:	\$113.85	\$123.29	- 7.7%
REVPAR	\$68.88	\$87.07	- 20.9%

Houston’s highest occupancy is in the Bay Area, Bush Intercontinental, TMC/Reliant Park and Galleria/Uptown (which also has the highest Avg. Daily rate through October 2009). REVPAR is highest in the Central Business District and Galleria-area. It is doubtful that this market will have any activity of substance for another year or two.

Retail

The University of Houston Institute for Regional Forecasting (IRF) predicts this market will increase slightly in 2010. Population and employment growth, residential construction, consumer confidence, and an increase in personal spending are drivers of this market. Longer term trends for Houston’s population and employment growth are very favorable. While some retailers are closing nationally, some are also expanding. In Houston, HEB plans to add new stores, Randall’s is planning some remodeling, and several restaurants (Beck’s Prime, Chipotle, Olive Garden, Red Lobster) also plan to expand. High-density residential suburban areas and a focus on dense Hispanic neighborhoods are a primary focus for many retailers.

RETAIL MARKET – 3rd Q 2009 (CBRE)

	3rd Q 09	3rd Q 08	% change
Vacancy:	14.4%	15.1%	- 0.7%
Lease Rates:	\$16.85	\$21.04	- 25%
Net Absorption YTD:	(607,186)	(1M)	Improved

CHURCHES/INSTITUTIONAL/MEDICAL

Churches

The Archdiocese of Galveston-Houston estimates they will have close to \$40 Million in projects this year. Typically, this number can be multiplied by 4 or 5 to cover all the denominations.

Institutional (Colleges and Universities)

This will remain a strong segment in 2010.

The UT System will have \$4.5 Billion over the next 5 years, which averages to \$900 Million a year.

The Lone Star System has \$75 Million bidding this year, on top of the \$200 Million that was bid out in December.

Baylor has \$4.5 Million for their infrastructure planned.

The Texas A&M system also has a lot of work, although much of it is still in the planning phase. Some projects announced include a Liberal Arts Building for \$34 Million and a parking garage in Corpus Christi, TX for \$18M. A research park just west of the College Station campus is also underway.

St. Thomas and Texas Southern University both reported no construction on the books yet, but that may change depending on market conditions.

Medical

The medical market will again have significant work. The U. T. M. D. Anderson system has a capital project budget of \$2.9 billion between now and 2015. Some of these projects are expected to get underway before the end of 2010. Methodist, St. Luke's, and the Veterans' Hospital also have major projects in planning and design. In some cases, contractors have already been selected. As soon as the national health care reform picture provides a reliable framework, many of these projects should move forward.

Institutions based in the Texas Medical Center are expected to add another 9-10 million square feet between now and 2014. Many of their projects are in the suburban areas. The University of Texas Medical Branch at Galveston has a budget of \$1.3 billion between now and 2015. They just awarded 5 major projects in Galveston, predominantly based on hurricane damage repair, totaling approximately \$700 million.

THE PUBLIC MARKETS

Port of Houston

Shipments were down 14% at 2009 year end over 2008.

2010 is encouraging due to the expansion of the Panama Canal, the recent addition of cold storage (food, flowers and other perishables), and new transports to Cuba. For the first time in nearly half a century, a shipping line will provide weekly transport from Houston's docks to Cuba. Local officials view this as the beginning of increased exports to a Latin American nation that still faces a partial trade embargo with the U.S.

With the Obama administration already easing some of the restrictions on trade and travel with Cuba, the Greater Houston Partnership's Jim Moseley said: "We're very optimistic that the embargo could be lifted during the first term of the administration, if not sooner. The effect is going to be tremendous." If the embargo is lifted, he predicted Houston companies would sell goods to Cuba's energy businesses as well as for the rebuilding of its roads and homes.

The Port of Houston Authority has over \$100 Million in spending planned at their 4 terminals, which includes purchase of equipment.

City of Houston

City of Houston CIP - 2010		
Department	Amount	Big Projects (Includes Design & Const.)
		Amateur Sports Park (\$5M)
		East Downtown Economic Development (\$10M – site/street/utility)
General Government Facilities	\$17.6 M	
Convention & Entertainment Facilities	\$2.2 M	Series of renovations/repairs
Fire Protection Facilities	\$4.3 M	Fire Station Renovation Program (\$2.8M)
		New Multifamily Const. (\$6.5M)
Homeless & Housing Facilities	\$55.5 M	Homeless Housing (\$2.3M)
		Julia Ideson Bldg. Restoration and Addition (\$17.6M)
Library Facilities	\$36.3 M	Palm Center New Library (\$7.2M)
		Lake Houston Park (\$3.8M)
Parks and Recreation Facilities	\$20.9 M	Kingwood Park and Community Center (\$3M)
Police Facilities	\$11.6 M	Fondren Store Front Replacement (\$6.9M)
Public Health Facilities	\$5.4 M	Animal Control Center North (\$3.6M)
Solid Waste Management Facilities	\$2.3 M	
		IAH Terminal D Remodel (\$57.1M)
		Terminal B Expansion (\$30M)
Aviation Facilities	\$145.3 M	Runway Reconstruction – Hobby (\$11.9M)
Total	\$301.4 Million	

NASA

NASA’s budget for Johnson Spacecraft Center includes:

- A JSC project for \$22 Million to revitalize the Administrative Support Building including major HVAC work, asbestos removal, electrical repairs, fire protection, etc. This project will be LEED Silver but will strive for Gold certification.
- Minor Revitalization of \$15.8 Million project to upgrade the sanitary sewer system, site electrical distribution, potable water piping distribution and emergency electrical systems.
- \$9.9Million to install a firefighting foam system at Ellington field, and upgrade to utility tunnel.

Harris County

Harris County will have \$70 Million in Building work.

OTHER PUBLIC WORK

METRO has planned \$1.6 Million in building upgrades at various locations. There will also be building projects from the various cities and counties in the greater Houston area.

SCHOOLS (K-12)

The K-12 market has over \$1 Billion in construction projects in the 25 districts that reported. This number could be higher based on possible construction from Aldine, Brazos, Dickinson, Ft. Bend, LaPorte, New Caney, North Forest and Pearland – some of the districts who gave no report.

Most districts are reporting small projects, with the exception of HISD, which expects \$500 Million in construction, and Spring Branch with over \$107 Million. Some districts reported that their low numbers this year are due to current legislation, which makes it difficult for districts to open new schools and pay the maintenance costs associated with it.

District	Budget	Projects
Alief	\$22.1 Million	Over 25 projects varying in size/scope
Alvin	\$44 Million	New elem. (\$14M), Junior high (\$28M), Misc. small projects (\$2M)
Angleton	\$14.25 Million	Renovations – GC has been selected
Channelview	\$12 Million	New Jr. High, new early childhood center, support center, classroom additions
Clear Creek	\$0	Potential 2011 bond election
Crosby	\$0	No construction
Conroe	\$52.7 Million	Various renovations/improvements to several schools
Cy-Fair	\$64.6 Million	All renovations/additions. No new construction due to budget constraints for operations/maintenance
Dayton	\$0	No construction
Friendswood	\$10.6 Million	Renovation of JH (\$7.263 M - could reduce), football stadium, and sports fields (\$3.4M)
Galena Park	\$5 Million	Finishing up bond with roofing projects and renovations
Galveston	\$3 Million	Repair elementary damaged by Ike
HISD	\$500 Million	Some has already been awarded
Huffman	\$0	No construction
Humble	\$4 Million	1 High School renovation
Huntsville	\$13 Million	1 High School construction and renovation
Katy	\$0	No construction. Preparing bond for November 2010
Klein	\$63.7 Million	Variety of renovations, possible \$120M HS (waiting for approval)
Pasadena	\$0	No construction
Sheldon	\$2.7 Million	Renovations to existing facilities, network operations center
Spring	\$12 Million	Renovations on 8 facilities
Spring Branch	107.5 Million	2 High School renovations, 2 Junior High and 2 Elementary schools
Texas City	\$59 Million	New High School, new admin bldg., renovations to 3 elementary schools
Tomball	\$28.2 Million	\$14M of that could be put on hold if enrollment doesn't improve
Waller	\$500,000	District Technology Building
Total	\$1.018 Billion	25 districts reporting (Last year – 20 districts and \$1.18 Billion reported)

Labor & Materials Costs – Human Resources/Workforce - Other Industry Issues

LABOR COSTS

The decreased market volume and the pressure on margins allow no room for labor cost increases, except on a highly selective basis. Most companies are freezing wages at all levels; many have decreased executive pay.

In the face of declining or stagnant salaries, companies are trying to find other ways to reward employees through recognition programs, career development and training, providing flexibility, and offering monetary rewards for high performance.

According to the 2010 AGC Houston Labor & Materials Cost Survey, labor costs are projected to remain about the same as 2009 with a possible increase of 0.5%.

Health care premiums will likely increase 9-11%, according to various surveys and projections. Health Care Reform is a big question still – and it remains to be seen what, if any, impact that might have on employer health care costs.

MATERIAL COSTS

AGC of America's economist, Ken Simonson, has reported recently that the "party may be over" for construction owners. Materials cost decreases have provided a major benefit to budgets over the past two years (particularly schools and other public buildings). This decline in costs is related to more than materials; during this down economy, competition for projects is fierce and highly competitive bids and narrow margins also contribute. Contractors will need to maintain profits to stay in business and those who survive this downturn will need to charge more.

The Producer Price Index (PPI) for inputs to construction showed a small increase in December. This is the first month since February 2009 that the PPI did not decline from year-ago levels.

According to the 2010 AGC Houston Labor & Materials Cost Survey, material costs decreased by 0.2% in 2009, but are projected to begin increasing by 1.38% in 2010.

Contributing to higher prices are China's expansion and active construction markets in other emerging economies, along with increases in energy prices (welcome in the Houston economy). Prices are likely to stay somewhat "in check" in the first half of this year, but watch for an uptick in construction costs near year-end.

HUMAN RESOURCES/WORKFORCE ISSUES

Immigration Reform

Immigration reform continues to be a top industry priority. Over one hundred bills were filed in the 2009 Texas Legislative session that referenced immigrants and immigration matters. Nothing of any consequence was passed related to mandatory identification, revoking of business licenses, use of E-verify, etc.

This issue remains at the forefront of workforce concerns. With unemployment at an all-time high, the availability of craft workers may not be a problem in 2010 – but a return to a good economy may create demand exceeding supply. Baby Boomer retirements will deplete the construction workforce of highly skilled workers, and craft training takes on even more importance than ever if the economic conditions return the industry to 2005-2006 levels of construction.

Workplace Litigation and Trends

Last year, employers were challenged with an explosion in Equal Employment Opportunity (EEO) charges and other employment lawsuits; 2010 may bring even more challenges.

In addition to taking a tougher stance on interpreting the Administrative and Outside Sales exemptions, the Department of Labor has announced it would hire 250 additional investigators to pursue minimum wage, overtime, and exemption classification violations. They will increase audits and efforts to catch violators of the wage and hour laws. Employers may want to consider performing their own audits to ensure they are in compliance.

In addition to wage and hour issues and the increase in employment discrimination lawsuits, other challenges include:

- Managing layoffs, working with decreased numbers of employees, and managing the growing use of temporary workers.
- Complying with new legislation likely to be presented allowing for more federal paid leave laws.
- Complying with the proposed new Employment Non-Discrimination Act. The current version of the bill under consideration in Congress would prohibit private employers with more than 15 employees from discriminating on the basis of sexual orientation or gender identity.
- Mental Health Parity and Addiction Equity Act of 2008, which affects group health insurance plans provided by employers of 50 or more.
- Union organizing drives and the Employee Free Choice Act are still potential issues.
- Compliance with the Genetic Information Nondiscrimination Act. This law protects Americans from discrimination based on genetic information when it comes to health insurance and employment. New Poster requirements apply.
- Impact of social networking, blogging, etc. on the workforce and productivity.

OTHER INDUSTRY ISSUES:

Green Building

Green Building requirements/LEED certification will continue and expand.

Building Information Modeling (BIM)

This technology can vastly improve building processes and create more collaboration among owners/architects/builders. BIM has been proven to reduce building costs, and may likely one day be a requirement on any building project. The percentage of AEC team members using BIM has accelerated in the past year and will continue to do so.

Lean construction

This method, which involves supply-chain management and higher levels of collaboration, is gaining favor with owners.

THE TEXAS PICTURE

We really should be thankful that we are in Texas! Overall, the Texas economy has fared much better than most. For example, the state-wide unemployment rate, like Houston's, is much lower than the National unemployment rate (8% vs. 9.7%). The BRAC (Base Realignment and Closure) program has brought millions in construction dollars to San Antonio (and jobs as well). Austin continues to enjoy a fairly healthy construction market, as does the Dallas/Fort Worth area.

Highlights from the recent Federal Reserve report for the 11th district (Texas, Northern La. and Southern New Mexico) provided more hope for an economic rebound:

- Single family housing permits increased 10.6% in December (month of December permits were 29% higher than a year ago).
- Residential home values are holding...not having fallen as much as the rest of the U.S.
- Exports rose 6.9% in the 3rd quarter, following a 1.2% increase in 2nd quarter, and exports are up 4% year/year in November 09 vs. November 08.
- The Texas rig count has been steadily increasing since June, 2009...although it is still down 43% from last year. Oil and gas prices are improving as well.
- The "Texas Leading Index" of key economic indicators that predict future economic activity, has been on the uptick from September through November, with all components showing marginal improvement.
- Staffing firms are reporting improved demand for contract workers.
- High tech manufacturing reports demand is growing, but construction-related manufacturers report flat or decreasing demand. In general, the industry outlooks were more positive than in prior reports.
- Retailers reported year over year sales are "less negative," and the "cash for clunkers" program added impetus to auto sales.

SUMMARY & CONCLUSIONS

The National outlook looks somewhat negative for construction. A recent National AGC survey of nearly 700 contractors found that 88% do not expect overall business conditions to improve until at least 2011. 30% of respondents expect to add workers in 2010, while 27% expect layoffs (some firms said “both”). 46% said they plan to buy new construction equipment in 2010, down from 61% who did so in 2009; for used equipment, the figures were 34% and 50%. 81% say they cut profit margins for their 2009 bids and 11% are willing to take a loss.

The *Reed* reports express a bit more optimism. *Reed* projects that nonresidential building construction will expand in the next twelve months, based on projects currently in planning and projects currently under construction. Perhaps surprisingly, the retail sector has the highest U.S. expansion projection, suggesting steady construction in 2010.

The improvement in the commercial construction market will likely come in the second half of 2010 due to the recent quarter-over-quarter increase in corporate profits, a marked strengthening of commodity prices and the steady strengthening of investor confidence, with business non-residential spending to accelerate and strengthen further in 2011.

While Houston is poised to benefit from higher oil and natural gas prices, key to a real recovery will require improved consumer confidence, employment growth and loosening of credit standards and terms. Most signs point to this by late 2010, but there are still many concerns about upcoming commercial real estate loan defaults and the U.S. financial markets in general.

The Greater Houston Partnership considers the level of economic activity in 2007-2008 to have been a bit of an anomaly. They anticipate overall economic activity in Houston will return to the 2005-2006 level. This same comparison appears to be true for construction contract awards.

2007 and 2008 were anomalous years, with new contract awards reaching \$5.1 Billion and \$7.2 Billion, respectively. New contract awards in 2009 (\$3.65 Billion) fall within the range of 2005 (\$3.4 Billion) and 2006 (\$4.3 Billion). We anticipate it will fall within that range again in 2010, perhaps reaching the \$4 Billion mark.

Resources: Greater Houston Partnership; Industrial Info Resources; McGraw Hill; Reed Construction Data; U.H. Institute for Regional Forecasting; IHS Global Insight; CBRichard Ellis (CBRE); Port of Houston Authority; Houston MSA ISD's; City of Houston; Harris County; Houston Airport System; U.S. Census Bureau; Bureau of Labor Statistics; National Association for Business Economics; National Association of Purchasing Managers; Texas Workforce Commission; AIA; Energy Information Administration (EIA); TxDOT; METRO; PKF Consulting; University of Texas; Texas A&M University; Lone Star College System; Baylor College of Medicine; Texas Medical Center; NASA; U.S. Federal Reserve