

2007 Houston-Area Construction Market Forecast



KILEYADVISORS

Leadership & Strategy

This forecast was produced by the Associated General Contractor of America, Inc. – Houston Chapter and Kiley Advisors. It makes no claim of being scientific. The information contained in this report was obtained from various publications and sources. Thanks to CB Richard Ellis, American Metro Studies, O'Connor & Associates, Grubb & Ellis, Greater Houston Partnership, Ken Simonson, and others who supplied information and assistance for this forecast.

Appreciation Anticipation Apprehension

The construction industry begins 2007 with feelings of grateful appreciation and eager anticipation. For good measure there is also a degree of healthy apprehension.

The appreciation stems from the fact that for most construction firms, 2006 was a banner year – indeed a record year for many. And as we enter the new year, there is a realistic anticipation that the good times will continue. As one pundit said, “contractors reflect a Buddhist calmness that comes from having money in the bank.”



There is certainly reason for this sense of well-being. Global growth is expected to continue, although the rate may decrease slightly. For example, US GDP growth, estimated at about 3.3% for 2006, is projected to be in the range of 1.9% - 3%, with most economists forecasting 2.5%. European Union countries are expected to experience collective GDP growth of about 2%, with a recovering Germany leading the way. The Asian economies will remain the stars with China (8.9%) and India (7.6%) being the frontrunners.

There is good reason, however, for apprehension as the new year dawns. Iraq remains unsettled with a troop escalation now underway. Iran and South Korea remain defiant. There is new leadership in the US Senate and House and a good friend is leaving office in England. Falling home prices in many parts of the country are not only chilling new construction activity, but are also destroying some of the “wealth effect” that has driven consumer spending.

Specific to the construction industry are two issues that are creating a great deal of anxiety. The first deals with the fact that this industry, particularly in the Southwest, relies almost totally on an immigrant workforce. Comprehensive immigration reform that recognizes and supports this fact is desperately needed. However the currently proposed solutions to address the illegal immigrant are short-sighted and highly punitive to legally compliant contractors. The wrong approach in solving this crisis would devastate the Houston construction economy, as well as many other related sectors.

Secondly, attracting enough people to the industry at all levels remains a major concern both now and in the future. A study by researchers from Texas A&M University, that projects the supply and demand for people with construction educations in the coming 15 years, even factoring significant expansion of current programs, is extremely sobering. There will definitely be a “war for talent.”

But on the whole, there are many more reasons for continuing appreciation and anticipation of good times, particularly for the US, for Texas and for Houston. There is a growing economy; inflation remains under control; interest rates remain favorable. The Dow Jones Industrial Average rose 15% last year, and is now above the 12,000 mark. Texas has a projected \$14 Billion surplus, a pro-business legislature and plentiful resources. And, Houston, always prominent world-wide for medicine, has even more international importance today as oil is the global “coin of the realm.” The major oil companies, the majority headquartered here, drive most oil related activities. In addition, Houston has a strong, competent mayor, a large and diverse population, and very favorable living conditions. It remains a magnet for many types of companies. Consequently, this town is thriving, and so should Houston construction again in 2007.



2006

The industry is coming off a fantastic year. A major Houston real estate services provider and real estate investment management group reported that 2006 provided their company with the best year ever, and that Houston had “the best market in at least 30 years.”

Through December, total contracts awarded in the 10 county Metropolitan Statistical Area (MSA) totaled \$13.1 Billion, a record year...with 9% increases in all three categories--overall, residential and nonresidential! Residential Contracts totaled \$9.46 Billion (73% of total contracts); Non-residential \$3.65 Billion (28% of contracts). But take a look at Texas contracts: up 16% at \$65.8 Billion, with nonresidential recording \$17.5 Billion (up 24%); residential coming in at \$34.8 Billion (up 6%), and non-building (streets/highways, bridges, etc.) at \$13.5 Billion (up 42%). These numbers again show that Houston and Texas fared better than most markets in 2006.

In comparison, Houston Building permits (through December) were \$4.7 Billion, with \$2.11 Billion in residential permits (new and alterations combined), and \$2.6 Billion in non-residential construction (new and alterations). Again, Houston is very alive with activity.

Last year, we increased the traditional benchmark dollars that determine when Houston has a strong construction market. We raised each of the four major sectors of construction (residential; heavy industrial; highway and municipal; commercial and light industrial) to \$2.5 Billion from \$2 Billion. Once again the aggregate benchmark of \$10 Billion was shattered by commercial and residential alone.

Houston’s overall employment grew by 72,400 jobs in 2006. At 3%, Houston enjoyed a more favorable growth rate than other major cities in Texas (Austin-2.8%; DFW-2.3%; San Antonio-2.2% and Statewide- 2.1%). Predictions are that this number will be even higher following March benchmark revisions. Construction employment showed one of the highest growth rates, adding 13,300 jobs – up 7.7%.

Total construction employment in December 2006 was 185,100. This compares to 171,800 in December ‘2005. Houston remains one of the truly great construction markets.

Drivers

Construction activity, particularly residential and commercial and light industrial, is driven by a number of factors. All are favorable as 2007 begins, and they are all projected to stay that way. Here is a review:

Interest Rates and Money Supply: “It is a good time to be borrowing money for construction projects,” says one knowledgeable banker. “There is an enormous amount of liquidity and Texas is particularly competitive.” Rates are about 7% for good projects. Equity requirements average about 25%. All types of commercial & light industrial projects can be financed. Condominiums may be near the end of their cycle, and there is caution about some single-family residential developments. However, overall conditions are still very positive.



Employment Growth: Houston’s employment is expected to grow again this year by 65,000 jobs - a 2.6% increase, according to the Greater Houston Partnership, and by a more conservative 2% (51-52,000 jobs) according to Dr. Barton Smith at the University of Houston’s Institute for Regional Forecasting. At 2.6%, Houston’s job growth will be stellar compared to the nationwide growth predictions of slightly more than 1%.



Energy Prices: Oil prices are projected to remain in the \$55-\$65 range throughout 2007, with the potential for dips and spikes outside that range. The expanding economies in both China and India alone will increase demand enough to sustain those levels, let alone the growth in the rest of the world. Houston's large base of exploration and production companies, as well as the many infrastructure companies that support them will benefit. The downstream chemical companies are not helped by prices at these levels. However, they will benefit if the dollar continues to weaken. Natural gas prices are moderating (January 1–24, 2007, Henry Hub averaged \$6.59 per MMBtu, down from December '2006 average of \$7.18), but still drive activity. There will be continued expansion, relocation and consolidation of energy production, refining, technology and oilfield services in Houston.

Absorption, Vacancy and Rental Rates: All these metrics are trending the right way. Absorption has been positive for 11 straight quarters in office space; 14 in warehouses and light industrial space. Vacancy rates have dropped to 13.8% overall for office space and an incredible 6% for warehouses and light industrial space. Rental rates are rising in both segments and incentives are disappearing; specifics will be discussed later in the segment analysis.

Architectural Firm Hiring: More architects are needed, and most firms are looking for people, especially experienced project people. Recruiting efforts now reach well beyond Texas. There is some outsourcing of production work to India and China, and competitive firms from all over are beginning to come here. The inability to hire may delay some projects, which may extend the market wave. Nationally, the Architectural Billings Index (a survey begun in 1995) finished 2006 with its highest score ever in the commercial/industrial sector, and showed improvement in the institutional market.

If the national and international pictures remain as they are now, all these drivers should remain positive throughout the year.



SECTOR ANALYSIS

Residential

Mike Inselmann, president of consulting firm Metrostudy, predicts housing will be a good market for builders in 2007, but still may be down slightly from the record year in 2006, when there were approximately 50,000 single family housing starts and more than 86,000 properties sold. Strong sales leave available housing at comfortable levels for more building, along with continuing employment growth, and favorable interest rates. Higher-end, "move-up" homes will fare better than first-time buyers' markets.



On a national level, inventories are high and stifling new construction. The number of homes waiting to be sold increased 51% in November 2006 from November 2005. However, recent reports have some economists expecting a rebound in the U. S. housing market next year, as new home construction declines and price decreases may contribute to more sales. The 2006 housing starts will be about 1.4 Million versus 1.6 Million in 2005. The 2007 forecasts reflect a predicted 1.2-1.3 Million.

Multi-Family

Houston multi-family construction had a good year in 2006, and has the potential to remain healthy in 2007. In 2006, 18,000 units were started, the most since 1998. Occupancy rates remain healthy through the fourth quarter – in the high 80%-90% range, even with Katrina departures (contributing to negative fourth quarter absorption of approximately 3,800 units). Average occupancy is 88.1% for all classes, with Class A having the highest average occupancy of 89.2%, and an average rental rate over \$.99 per square foot. Currently, nearly 14,000 units are under construction, which clouds the number of new starts in 2007.

According to McGraw Hill, nationally, the multi-family market increased 18%, adding significantly to the \$292 Billion residential market in November.. While multi family should see some slowdown in 2007, it will more likely be in those areas where condos have been overbuilt, or where there is an oversupply due to conversions. However, while these conversions depleted much of the apartment supply, vacancy rates are still favorable for development, even in "overbuilt" condo markets, where conversions have reverted back to "re-partments."

Highway/Municipal/Utility

It appears that 2007 will be another great year for those contractors that do highway/municipal/utility work. TXDOT is planning a total of \$832.2 Million with \$639.7 Million in the Houston District; the Bryan District has another \$40.4 Million and the Beaumont District will add \$152.1 Million. Keep in mind that due to their fiscal year, these numbers only include those projects from January to August of 2007, meaning even more projects will be let before the year ends!

City of Houston projects will be down by 25% but there will still be a very healthy amount of work. The 2007 fiscal year began in July 2006, therefore the 2008 year will start in July 2007 and run thorough June 2007. During that year period, they will award approximately \$787.9 Million in these type projects, compared to just over \$1 Billion last year: Storm Water has \$78 Million; Street and Traffic Control \$242 Million; Street and Traffic Control has two hike and bike trail programs totaling over \$25.5 Million in 2007; Aviation \$74.1Million; Wastewater \$203 Million and Water \$80.5 Million.



TIRRS has pedestrian improvements and street reconstructions making up their \$50.2 Million budget. The Convention and Entertainment division has a \$25,000 parking lot resurfacing project.

The Port of Houston will spend a total of \$259 Million between 2006 and 2007, of which \$211 Million is at the Bayport facility, where they are looking to substantially increase their capacity. Approximately \$25 Million earmarked for building work.

Harris County expects over \$151 Million in Civil work, with over \$121 Million of that going toward concrete paving. Then there are all the neighboring counties, Metro, plus all the private developer work relative to the new subdivisions. This sector is still doing considerably well and should meet its \$2.5 Billion metric.

Heavy Industrial

One of the largest industrial areas in the United States, the Gulf Coast Region is a five state area, from the Florida panhandle covering the entire Texas Coast. Within 12 industry segments, there are approximately 480 chemical plant locations, 40 major petroleum refineries, 300 food and beverage plants, 225 bulk storage terminals, and 125 power generating stations. The Gulf Coast region's oil and natural gas production, network of pipeline and terminal operations, and access to large commercial ports creates an attractive investment zone.

The Industrial market is in a "revival" mode. The past trend in industrial plants has been contraction rather than expansion. However, the rate of contraction decreased in 2006 as strong new plant construction trends in several industries cancelled out closures in others.

The advent of alternative fuels (biodiesel, wind farms, solar, fuel cells, etc.) is generating a good portion of a very healthy industrial market for Houston, which is well positioned to become a center for alternative energy companies. Already, BP Alternative Energy North America, Inc. chose Houston for its headquarters, and Rice University recently convened a major conference regarding biofuels' potential as an alternative to oil-based fuels. With this kind of activity it appears that opportunities abound.

Industrial project spending in Texas will significantly increase in 2007, according to Industrial Info Resources. Currently, there are 473 industrial projects in Texas totaling more than \$27 Billion, and planned to start in 2007—46 additional projects and \$9 Billion more than 2006 planned projects. These projects include billion-dollar coal-fired projects, petroleum refining projects (primarily for capacity expansion), Oil and Gas transmission projects for pipeline and compressor station work, and Alternative Fuels spending with ten projects totaling \$682 Million. Other industrial industries (Pulp, Paper and Wood, Pharma-Biotech, Metals and Minerals, Food and Beverage, and Chemical Processing) will stay about the same, or experience some decrease. The Oil and Gas Terminal industry will see a drop in spending due to LNG terminal projects that moved forward in 2006.

Approximately 50% of the state's industrial spending will be in the Power Industry. Some construction plans include Oak Grove Management Co., TXU Power, Inc., Sandy Creek Energy Associates, and NRG Texas, LLC with Billion-dollar coal-fired projects in Texas. These projects will contribute \$14 Billion for 73 projects planned.

Projects for the Southwest region, (Arkansas, Louisiana, Oklahoma, and Texas), with approximately \$50 Billion from 875 projects, leads the traditionally first-place Great Lakes region as the area with the most planned spending for 2007. Energy projects, such as coal-fired gasification and power plant projects, comprise most of the larger projects in the Southwest region. Large-scale natural gas pipeline, petroleum refining, and LNG terminal projects are also being evaluated. By far, the largest project planned to begin construction is a grassroots, \$5 Billion coal gasification plant. Synfuel, Incorporated in Baton Rouge is permitting the plant to be



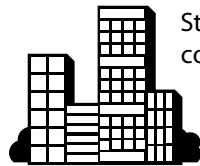
located in Geismar, Louisiana. The project will produce gasoline, LPG, syngas, methanol, steam, and sulfuric acid from coal, and will include a cogeneration plant of an approximated 500-megawatt capacity.

Nationally, an estimated \$254 Billion in activity is scheduled – predicted to wind up at around \$110 Billion in actual spending due to typical delays and/or cancellations in this industry.

Commercial and Light Industrial

THE PRIVATE MARKETS

General Purpose Office Space



Strong job growth in Houston has been a boon to the office market. In 2007, strong growth will continue in professional and business services, as well as educational and health services, both of which generate demand for office space.

The office market is performing at higher levels than we have seen in many years. A total of about 5.5 Million square feet of office space was absorbed in 2006, with the Central Business District (CBD) and Galleria/ West Loop area leading the way. Class A space which represents about 45% of the total office space in Houston has now experienced increases in occupancy and absorption since the beginning of 2005.

Overall vacancy rates dropped to 12.04 % at the end of 2006. Class A vacancy rates dropped to 9% overall with the Energy Corridor, Westchase, CBD and West Loop areas being the lowest. Class A rental rates increased everywhere, with the CBD now experiencing asking rates of \$26.72/Sq ft. and Suburban areas, \$21.94. Additional increases in rent of 8% in Class A Space and 6% for Class B Space are projected for 2007.

Construction activity was robust in 2006 and is projected to stay that way in 2007. The year ended with 2.5 Million square feet of office space under construction. Already there have been announcements of the 97,000 square foot Point Center office project in Mid-town and the 5-story speculative Chasewood Technology Park at Chasewood and Hwy 249. A second building is planned there as well. Many others are planned, particularly in the energy corridor. A projected 3 Million square feet of new office space should be started in 2007.

On a national level, there have been ten consecutive quarters of declining vacancy, and estimates are that 2006 will bring 46.4 Million square feet. in new office space, up from roughly 37.2 Million square feet. for the full year of 2005. Office vacancy rates are projected to drop to an average of 12.1% in the fourth quarter of 2007 from an estimated 12.9% currently - the lowest since 2001.

Light Industrial/Warehouse/Service Center

A real increase in warehouse space exemplifies Houston's active industrial market, with 3.7 Million square feet added in 2006 and at least that amount under construction at year end. CBRE reports the industrial market in Houston has seen eight quarters of positive absorption – 4.1 Million square feet. in 2006. Energy and related oil field services are major drivers.

This past year, the Houston Airport System has been one of the drivers with a 31% increase in total international cargo service. IAH in particular, is adding flights and projects cargo increases of well over 6% for 2006. The addition of China Airlines to IAH is focusing on developing opportunities with Houston's petrochemical, medical, aerospace and information technology industries. Other international airlines are looking to expand Houston's



international trading lines with Asia as well. A new 61,000 square foot perishable facility will come online at IAH in 2007, further adding support for cold storage cargo import and export. More facilities are probable.

The Port of Houston's new Bayport Terminal has expanded the number of area distribution centers. The facilities are attracting more national and global companies who are taking notice of Houston's strength and capacity, which will drive more construction activity in this area in 2007.

The lowest vacancies are in the CBD, South and Southeast markets at around 4.1%, 5.4% and 5.7% respectively, and the overall vacancy rate is a very encouraging 6.2%. Land prices are increasing and industrial markets may become located even further out due to competition from retail and residential developments.

This sector is poised for continued expansion throughout 2007 and at least another 3.5 to 4 Million square feet will be started under construction in 2007.

Hotel/Motel

The hotel/motel sector end on a positive note in 2006e: occupancy up to 70% (from 68%); rates up 6%; revenue per occupied room up 8%. Consequently, there is activity in many areas with the exception of Downtown. In Pearland, two select service properties have been announced; a Hilton Garden and a LaQuinta, and two others are under consideration. In Sugar Land, a Hilton Garden is also announced, and in the Woodlands, an all suites property is planned. In Clear Lake, two properties are planned, one full-service, one select-service.

The three properties out I-10 near the Beltway mentioned last year should be started this year--a Westin, a Sheraton Suites and a Sheraton Four Points. Four luxury hotel groups are looking at the Galleria area; two may be started before the end of the year. Some of these are the trendy boutique hotels popular with the young professionals. In Downtown, the Sam Houston changed ownership and became The Alden and the Icon was sold to new owners. Hopefully this year will see the downtown hotels gain ground.

National hotel trends reflect the same positive picture, with occupancy up .5%, rates up 7% and revenue per occupied room up 7.5%

Retail



The Greater Houston area is one of the most active retail markets in the world. In 2006, 19 centers, adding up to 2.3 Million square feet, were completed. And, due to the healthy residential market in Houston (even with some decline), retail will continue to do well in 2007. Currently, 46 centers, which will add nearly 12 Million square feet, are under construction at year end! Overall vacancy is at 14% or less, and rental rates average a healthy \$15-\$30 per square foot. Lowest vacancy rates are the inner loop (9.64%) and the far northwest (10.9%).

Lifestyle Centers are the hottest trend in retail markets, throughout the country and especially in Houston. One real estate firm defines lifestyle as "places where people go to shop, eat, and enjoy." They include pedestrian walkways, drive-up parking, nice architecture and landscaping, and typically boutique type retail with quality restaurants.

Mixed use developments, the "big brother" of retail developments, would add office space and residential to the lifestyle center concept...where people can wake up, walk to Starbucks, then on to the gym, back home to dress for work and then walk, or ride the elevator, to their office. The busiest retailers are the fitness centers and sporting goods stores.



Another new trend in retail is offering internet shopping to buyers, who then pick up merchandise at specific local store locations.

Major planned developments abound in all areas of the Houston metropolitan area -- \$100 Million mixed use project in Clear Lake, with condos, office buildings and retail is slated for early 2007; the Promenade Shops at The Spectrum in Pearland (an 800,000 square foot lifestyle center); several retail projects in and around the Woodlands Area, around new 249/Tomball Parkway residential developments, and in the expanding areas out west toward Katy.

Grocery anchored community centers are losing favor. Also, look for declines in growth of stores like Old Navy, Pier One, video stores and, with the growing popularity of e-mail cards, and specialty card shops.

As long as consumer confidence, our economy, interest rates and housing construction remain stable, so will the retail market. Houston should see another 3.5 Million square feet start under construction in 2007.

Churches/Institutional/Medical

- **Churches**

This segment continues to be strong and is expected to produce between \$75–100 Million in 2007. Of that, the Archdiocese of Galveston/Houston will have about \$20-25 Million in 2007, all of which was bid in 2006. In addition, they will spend \$14 Million on the new Cathedral, which is scheduled to open at the end of the summer, bringing their total to between \$34-39 Million, with the remaining denominations rounding out the segment. Larger sanctuaries and sophisticated broadcast and audiovisual equipment installations have raised the price of the average church significantly.



- **Institutional**

Over the next five to seven years, Texas A&M University plans projects totaling \$675 Million, the University of Texas looks to bid \$1.3 Billion and the University of Houston is planning \$156 Million. Texas A&M University has many projects in design and several more in the programming phase. Projects include a new IBT Animal Facility in Houston for \$3.7 Million, a Texas Tech Institute State Headquarters Research Building for \$6.9 Million, and a Nuclear Magnetic Resonance Center for \$6.1 Million.

The University of Texas at Galveston will spend \$92.28 Million, which includes renovations and upgrades as well as a new student housing facility for nearly \$19 Million and a new clinic facility for \$30 Million. UT plans to spend about \$132 Million in Houston. The Health Science Center is planning \$25 Million, which includes an expansion of the Health Information Science Center for \$3 Million and the Mental Sciences Institute for \$22 Million. The UT M.D. Anderson Cancer Center will have \$108 Million, with an administrative support building at \$60 Million, a mid-campus central parking facility for \$24 Million, MSI Building demolition for \$3M and the Rotary House International Phase III for \$21 Million.

Baylor College of Medicine expects to spend \$40 Million in 2007, including the completion of research tower with a few additional \$1 - \$3 Million and several projects below \$1 Million. St. Thomas does not expect any work in 2007, while Houston Baptist University expects some construction, but is still in the discussion phase. The North Harris Montgomery Community College District failed to get its bond approved in the November 2006 election. Add in the amazing amount of work at Rice and Houston Community College, you can see that the Universities continue to be a solid market.



- **Medical**

There are not enough superlatives to describe the outlook for Medical construction in Houston, both in 2007 and or several years into the future. This market is primarily driven by the building programs of those institutions with facilities in the Texas Medical Center.



According to Dr. Richard E. Wainerdi, CEO of the Texas Medical Center, Inc., TMC groups will add between 4 Million and 8 Million square feet in the coming five years. Much of it will still be on the greater TMC campus, as is the case with facilities either announced or planned for 2007 with M.D. Anderson, Methodist, Texas Children's, St Luke's and Baylor. But a growing amount will also be suburban, feeder facilities, as planned by Texas Children's, Methodist, and St. Luke's, and as the Memorial Hermann System has done so effectively during the past few years.

There is no question that the international reputation of Houston Medicine is a major contributor to this continuing expansion. This impact should not only continue but increase, and all the TMC-based institutions have aggressive outreach programs to countries around the world.

THE PUBLIC MARKETS

Cities/Counties/Other Public Entities (Other than Schools)

The City of Houston has some very promising projects with over \$697.4 Million in their '2007/2008 Capital Improvement Program. The Fire Department will spend \$18.54 Million, which includes two new fire stations totaling \$6.4 Million, the renovation and expansion of their training academy at \$5.3 Million, and a fire station renovation program budgeted at \$4.4 Million. The Library Department has \$21.2 Million, including the Kendall, Bracewell, and Vinson library replacements, which total over \$10.6 Million, and the construction of The Gregory School at \$4.6 Million. The Parks Department has \$17.6 Million budgeted, with Hermann Park Trail and park improvements, the largest projects, totaling over \$4 Million. Police has \$50.1 Million including \$32.1 Million for a new prisoner processing facility and the relocation of their mounted patrol facility, budgeted at \$5.6 Million. Public Health has \$7.88 Million including \$2.6 Million for the Braeswood Lab Renovations and \$2.99 Million for the Kashmere Multi-Service Center. Solid Waste has \$2.4 Million with a recyclable material delivery facility for \$700,000. General Government Facilities has \$15.4 Million including the Magnolia Multi-Service Center expansion for \$3.2 Million and the South Post Oak Multi-Service Center at \$4.9 Million. The Homeless/Housing Department expects to spend \$8 Million on both single-family and multi-family housing improvements. The Wastewater Department has \$120.4 Million in commercial type work including a new wastewater treatment facility for \$13.3 Million, a pump and lift station replacement for \$22.8 Million, and a sludge plant renewal/replacement for \$42.9 Million. Aviation has \$112.2 Million which includes an expanded airport service complex for \$11.2 Million, a \$21.6 Million remodeling of Terminal D and \$53.3 in various security enhancements.

Harris County anticipates over \$118 Million in building projects for 2007, with the majority of projects being renovations, expansions, parking lots and park developments.



Schools (K-12)

The School market will be strong again this year, with a variety of both large and small projects, which will total between \$900 Million and \$1 Billion in work. Channelview has projected \$26.5 Million in projects in 2007, which includes a \$20 Million 9th Grade Center. Cy-Fair ISD expects \$185 Million, which includes two elementary schools, a new middle school and three major renovation projects. Fort Bend plans to bid out nearly \$16.8 Million in the Fall of 2007, with over \$100 Million currently under construction and \$270,000 which has yet to be scheduled for bid. Galveston is still in the process of approving projects, but has decided to go forward with a new softball field for \$1.9 Million.

Humble ISD has \$210 Million in projects for 2007, though all projects have already gone through the bidding process. Katy ISD has \$135 Million in the works, including two elementary schools and a junior high school, with another \$41 Million already being budgeted for an additional junior high and elementary in 2008. Continuing from their 2004 bond election Klein ISD plans to spend just over \$41 Million on two elementary schools, the completion of an intermediate school, additional temporary building placement and various technology, support and facility upgrades. La Porte ISD has an additional \$8 Million to bid in 2007. Pasadena ISD has two intermediate schools which bid in December 2006 for \$39.9 Million, with two additional middle schools to be bid in 2007 for \$26 Million.



Pearland has several large projects, totaling \$115 Million, over the next three to four years. For 2007, it looks as though they plan to build two elementary schools at \$27.2 Million total, along with various technology and facility improvements. In addition to the \$15.9 Million bid in late 2006, Sheldon ISD expects an additional \$3 Million to be bid in the summer of 2007 for renovation projects and a transportation facility. If Spring ISD's bond passes in May 2007, they plan to hit the ground running with \$53 Million on a middle school and two elementary schools. In the meantime, they will be finishing up the \$55.9 Million Dekaney high school project Spring Branch ISD expects to spend \$7.5 - \$8 Million in 2007, with projects ranging from athletic dressing rooms to roof replacements. Alief ISD only has one large project remaining to bid in 2007, which are classroom wall enclosures for \$1 Million.

HISD has bid out all projects remaining on their current bond program in 2006, and will spend this year gearing up for another bond election in November 2007. Tomball ISD expects to propose a bond in May 2007, and hopes to have projects underway in the third quarter, while Friendswood is discussing whether to put out a bid in 2007 to install lighting structures in their auditorium. Alvin, Crosby, Dayton, Brazos, Waller and Huffman ISD's are all predicting no work in 2007.



LABOR & MATERIALS COSTS AND OTHER INDUSTRY ISSUES

Labor

Labor markets everywhere are extremely tight. The 2006 Houston MSA average unemployment rate is 5%, down from 5.5% in 2005. This creates a major source of apprehension for both contractors and design firms. There are people shortages at every level of these organizations.

At the skilled craft level, the gap between the number of people with historical craft training and those without widens weekly, and the number of people in formal, registered apprenticeship programs is historically low as a percentage of the workforce. The construction industry is competing with many other industries for this shortage of talent-- manufacturing, industrial markets and the energy service sectors all report issues with the availability of skilled labor at many levels.



Many economists and labor market experts say that job growth and the overall economy would be significantly stronger if more skilled workers were available. Some even blame the economic slowdown in the second half of 2006 on labor constraints. While unemployment rates are low overall, the unemployment rate for college-educated workers was just 1.8% in November – almost meeting the all-time low of 1.5% during 2000. And, many companies who are experiencing slow periods are afraid to cut staff for fear of not being able to hire when business conditions improve.

Experts agree the shortage is likely to persist for quite sometime .with Baby Boomers leaving the work force and increased demand for workers. And a new trend is popping up —“gray hair sites”—with growing numbers of job boards on the internet catering to the mature worker.

Therefore, it is no surprise that wages are increasing at a higher pace – closer to 4% compared to 3.0%- 3.5%, and the focus is shifting to “pay for performance” or incentive-based plans.

Healthcare costs continue to plague all businesses. While U. S. companies experienced the lowest health care cost increase in several years, the overall rate of increase is still a major concern for both employers and employees. It outpaces inflation and salary increases. In 2006, average health care rate increases were 7.9%, according to Hewitt Associates, a global human resources services company, and they project a 7.7% average increase in 2007.

Materials Costs



Watch for AGC Houston’s Annual Labor and Materials Costs Survey results to be distributed and posted on the web site mid-February (www.agchouston.org). This survey, conducted for the past ten years, reveals the predictions of Houston’s specialty contractor and supplier community. Area costs can vary greatly, based on supply and demand, as well as other inputs such as labor, transportation and energy costs – these survey results are a good way to forecast what the coming year might bring.

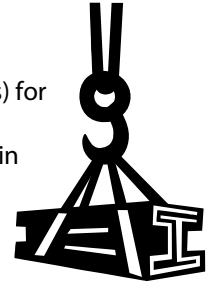
While 2007 will offer some relief in materials costs increases, costs will still rise at twice the rate of inflation – averaging about 6-8% versus the sharp increases experienced over the past couple of years. Certain materials will continue to show price volatility due to demand, transportation and production issues.



China's economy continues to rapidly expand and their materials demands contribute to shortages and price increases. However, China's new status as a world leader in stainless steel production, with production capacity reaching 12 Million tons at the end of 2006, should alleviate supply problems and price increases for this product. Additionally, China expects 20 new plants to begin production this year.

Reed Construction Data reports that the plunge in new home construction caused a 13% fall in lumber prices, an 8% drop in plywood prices and a 5% fall in gypsum prices— but this also works as good news for homebuilding, offering some, but not dramatic, cost relief. Watch for prices to increase, however, if homebuilding rebounds (as some predict), creating greater demand. Most other residential and nonresidential construction materials will continue to see cost increases.

Overall, worldwide growth and tight supplies will continue to create demand (and cost increases) for steel, cement, copper, gypsum and other basic building products. Steel prices increased 5% and concrete 6.5% during 2006 – and even these seemingly moderate increases (compared to those in the past) can impact planned projects. A \$5 Million project costs \$250,000 more with only a 5% increase.



The dip in diesel fuel prices will help for a while, due to reduced transportation costs...but look for increases to begin again in the second quarter.

The Houston CPI (consumer price index) rose 1.1% between December 2005 and December 2006 and 2.5% nationwide. A slowing in the growth of the CPI over the past year is encouraging, and the 2.9% increase in energy prices in 2006 shows much improvement over the 16.6% increase in 2004 and 17.1% increase in 2005. While core inflation is accelerating a bit, it has shown signs of slowing during the last half of 2006. With 2% being the comfort level for the Federal Reserve, hopefully this trend will continue.

Given that commercial construction is predicted to have another good market in 2007, the supply and demand factor could push price increases beyond predicted levels. It seems good news and bad news goes together!

Other Construction Issues

In Mayor Bill White's recent State of the City address at the Greater Houston Partnership, he emphasized the need for energy conservation and recycling, challenging Houstonians to cut residential and commercial power consumption as well as fuel consumption. According to Mayor White, the goal could be accomplished by implementing a mix of education, incentives and new standards for construction — without hurting the area's growth.

There are some trends that are on contractors' minds. The Building Information Modeling (BIM) 3-D systems are now being specified by GSA in the design phase for fiscal year 2007. Look for more requirements for BIM in the future.

The Green movement continues to gain momentum both in the private and governmental sectors. It is not uncommon to see questions from both groups in both Specs and RFPs that relate to the number of people that a contractor has on staff with LEED certifications.



Several public entities (agencies, cities, and counties) have passed or are proposing legislation mandating LEED construction, requiring the public entity's commercial projects funded in 2008 or later to attain "green" or "LEED" certification.

Currently, 18 states and 11 federal agencies use the standards for their projects. Look for more of these public entities to propose "green building" standards in 2007.

The Potential "Killer" Issue:

Certainly an international tragedy, like 9/11 would disrupt this forecast and wreak economic havoc throughout the world. However, the single most devastating impact for the Houston Construction Community would be the deportation of all immigrant construction workers in this area with "no match" social security numbers. Such action is now proposed by a rule from Homeland Security's Immigration and Control Division (ICE).

Deportation of these workers, many of whom are on payrolls of legitimate contractors who pay social security and taxes, would bring all types of construction in Houston to a complete stop. It would cause delays, defaults and raids for employees. The trickle down effect would be staggering, affecting many professional and management employees as well.



Fortunately for the industry, a group has formed to urge comprehensive immigration reform that recognizes the construction contractors' needs for the immigrant labor force. Texans for Sensible Immigration Reform (TxSIP), strongly supported by the AGC Houston Chapter and many other industry associations, is working daily with members of the US Senate and House of Representatives, and with the President's

Immigration Advisor to insure that legislation is introduced and enacted that is realistic for the industry. Hopefully this is achieved before the end of 2007.



CONCLUSION

Two major construction forecast groups, FMI and Reed, both project continued national growth in construction spending in 2007. FMI calls for \$1.18 Trillion and Reed for \$1.23 Trillion in overall US spending. According to FMI, \$420 Billion will be non-residential; Reed \$404 Billion. If Houston's traditional 1% share of national volume holds, non-residential construction should hit the \$4 Billion mark and overall construction should reach \$12 Billion. From this vantage point, contractors should continue to fare well in the market.

As mentioned earlier, excitement reigns in Houston as we enjoy and appreciate the great market we are experiencing. We can anticipate continued excellence, particularly in certain sectors such as Office, Medical and Industrial. But, our excitement is tempered by apprehension, created by concerns about global terrorism, unfavorable immigration reform, worker shortages, and inflation concerns.

