Breaking Ground

THE MAGAZINE OF THE MASTER BUILDERS' ASSOCIATION OF WESTERN PENNSYLVANIA

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THE BIG PICTURE: Confidence In 2014

Three forecasts for 2014

What owners want in an RFP

The Power of 32 'super' region

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Overbrook Pointe
Mars, PA

Photo by
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MBA

Publisher's Note

We're on the verge. The industry, the economy, the region all prepared for a boom again. That's my take at the start of 2014. Of course, that's been my take for more than a year. It makes you wonder whether or not I understand what the phrase 'on the verge' actually means.

Back in the winter of 2009, I attended an economic breakfast that featured economist Bob Bach from Grubb & Ellis (now Newmark Grubb Knight Frank) and PNC's Stu Hoffman. After talking for a bit about the crisis and the hits the economy had taken, Hoffman spelled out what he saw as the recipe for a recovery. There were several technical ingredients but Hoffman also pointed to a key emotional ingredient that was missing in 2009: confidence.

As he often is, Hoffman was on target back in 2009. What he couldn't foresee then was just how long it would take for sufficient confidence to return. Well, as we look out into 2014 it seems like the missing ingredient could return, provided we get no more setbacks like credit downgrades or shutdowns or sequesters to shake things down again. Perhaps it's more accurate to say that we're in a place – at least in Pittsburgh – where our confidence will turn on good news about just one big thing.

We'll talk a bit more about what that big thing might be in our 'Big Picture' feature article a few pages ahead in this edition (my money is on the cracker). I find myself wondering less about whether or not we'll get some good news than about what we'll do with that news.

I'm reasonably sure that whatever ends up giving us confidence about the economy again will trigger a few good years for our business, maybe more. I just don't know how we'll handle it. My experience with the construction industry in Western PA goes back to 1994. During that time, there weren't a lot of years where the industry took it easy and only picked opportunities for work that were going to be comfortably profitable. Many of those years were difficult ones, with profits sort of pushed out of the equation in favor of survival. Pittsburgh companies know how to compete and beat each other black-and-blue until the rising tide of 2005 through 2008 lifted everyone's boat.

For those years before the recession, companies serving the construction industry prospered. Those years were good for the designers, for the contractors and for the whole supply chain. Since then, of course, survival became job one. That survival mentality has been with us through five full years and the conditions have left a few scars.

When the recession set in, there were a number of comparisons to the Great Depression. Many pundits have even referred to it as the Great Recession. Americans have a well-deserved reputation for hyperbole but the financial crisis was hard to exaggerate. More than a few observers speculated that the recession would have the kind of lasting impact on our generation that the Depression had on our grandparents. The thing is, we won't know until there are good times again.

My hope is that companies will remember how to say no again. It may be that the best thing about a boom is the opportunity it provides for you to choose the people with whom you don't want to work. After five–plus years of looking under every rock for business it may take a while to adjust to finding it. If 2014 goes like I think it will, companies that build a backlog of cheap work going into 2015 will wish for a second chance to say no to some of their projects. It's unfortunate, but you only get one shot at that decision and it's very easy for someone like me sitting in the stands to be philosophical about someone else's backlog.

Speaking of how I see 2014 unfolding, the Regional Market Update has a little different approach to the forecast this year. Being wrong about the economic recovery for the past year or so has made me gun shy, so instead of a bold prediction what you'll read about are three possible outcomes. As you might guess, I'm most comfortable with the 80 percent forecast but I can make a case for the things that could happen in the 50 percent forecast. Spoiler alert: the 80 percent forecast is the one that says we're on the verge (again).

Jeff Burd

REGIONAL MARKET UPDATE

In the final analysis, the year 2013 will go down as one that perpetuated the trends rather than a year of change. After a year of gridlock and indecision in 2012, this past year began with the overblown fiscal cliff and plenty of promise for increased construction activity; however, the lack of clear direction in the global recovery blunted decisions to proceed at the local level.

Several significant trends dominated the region's construction industry. The housing market moved from robust recovery to boom, especially in the multi-family sector. Public owners continued to struggle with budgets, as improving revenues were insufficient to cover needed capital improvements. The City of Pittsburgh experienced population growth again as the emerging economic sectors developed further and attracted more new employees. Unemployment in Pittsburgh fell to 6.1 percent by October and may drop below six percent after the final analysis by the Department of Labor. Growth of the energy sector slowed but still provided enough inertia to create hundreds of millions in infrastructure and midstream spending.

Energy, in particular natural gas, was an industry that felt a few bumps in 2013. Gas prices trended slightly downward for the full year, although the price was roughly 100 percent higher than the cyclical lows in April 2012. The suppressed price and higher operating costs of the big producers that now dominate the drilling in the Marcellus and Utica shale formations slowed the growth of new wells. Development of further processing plants in the metropolitan Pittsburgh area slowed accordingly, although construction of separating and distribution facilities in northern West Virginia and eastern Ohio continued.

An acceleration or deceleration of the gas industry's expansion will be a key factor in the health of the construction industry in 2014. Likewise, the confidence or skepticism about the sustainability of what seems to be a more robust national economy will trigger or defer the start of projects that have been planned for several years. The construction outlook for 2014 will be highly influenced by just a few significant decisions and thus, the year could unfold in several different ways. Here are three scenarios and their probability of occurring:

The 80 Percent Forecast

The foundation for this most likely scenario is a more rapidly growing U. S. economy and a mildly improving global market. This forecast accepts the more prevalent opinion that U. S. gross domestic product (GDP) will be more stable but remain around 2.5 percent throughout 2014. That rate of growth – particularly if GDP remains consistent from quarter to quarter – should provide enough assurance to Pittsburgh-area developers for more projects to begin.

Commercial properties will continue to heat up as the first quarter unfolds. With true speculative office buildings underway at Southpointe II, Southpointe Town Center, Schenley Place, Pittsburgh International Business Park, Westpointe IV and several other smaller locations, the office building has joined apartments and hotels as hot property types. The pipeline suggests that these types of buildings will remain the most active in 2014, although the arc of the business cycle differs for each type.

Apartment projects were the lifeline for commercial real estate during the recession. As the first property type to experience expansion in 2010, apartments have reached or passed their cyclical peak as 2014 begins. Through November 30, 2013 just over 2,600 units of multi-family new construction had been started. While more than 2,500 units of additional apartment supply are in the planning or entitlement stages for 2014 and 2015, the supply that will hit the market throughout 2014 should require more time for absorption than was seen for apartments that came on line in 2012 and 2013. Support for apartment construction has come both from economics and demographics. With the economy recovering more strongly, 2014 will be the year to see if there truly are more lasting changes in the rate of home buying versus renting.

BENCHMARK	2012	2013 (f)
Total SFD units	1,936	2,009
Total SFA/Multi-unit	1,643	3,642
Total residential $$	$736.9 million	$1,040.5 million
Total non-residential $$	$2.62 billion	$2.82 billion
K-12 Additions/renovations	$233.9 million	$211.5 million
Hospital construction	$251.5 million	$316.9 million
Hotel construction	$76.9 million	$167.9 million
Industrial construction	$266.9 million	$276.8 million
Office construction	$593.6 million	$585.4 million

Construction on the Tower at PNC Plaza has moved well into the steel erection phase.

Development of new hotels will continue in the downtown market and along the I-79 and Airport corridors and are now moving into tertiary submarkets like Millvale and Connellsville.

Public construction will continue to be slower than normal due to funding gaps that have remained from the deep drop in revenues during the recession and the increasing burdens of pension obligations. The significant political influence of groups that support legislators who oppose new or increased taxes will limit funding for capital programs. Construction in the K-12 market will be sluggish, with a few large projects moving through the planning process in 2014. The Department of Education's moratorium on PlanCon approvals in 2013 effectively deferred major projects from moving ahead until the coming year. On the higher education front, similar funding challenges exist and the coming decline in enrollments that is forecast for later in the decade looms as a limiting factor on construction.

Another segment facing uncertain funding and future conditions is healthcare. The hospital sector is facing pressures from the shifting landscape of reimbursement under the Affordable Care Act and the uncertain outcome of the competitive struggle between UPMC and Highmark.

Heavy and highway construction is the one segment of public construction that will see a significant uptick, although the business impact will be muted in 2014. The comprehensive transportation bill passed in late November should sweeten the pot for heavy and highway contractors but the timing of the legislation – along with the uncertainty of its passage until after the eleventh hour – put engineers behind the eight ball to get projects to the street early enough to have a major benefit for the industry in 2014. The improved activity for PennDOT, PA Turnpike and municipal construction will be felt in 2015 and beyond.

Royal Dutch Shell maintained that it was still doing an evaluation of the Monaca site for the ethane cracker but at year's

The hotel "boom" in Pittsburgh has likely also seen its zenith until an acceleration of the economy occurs, although construction of another eight-to-ten projects is likely. According to hotel/travel consultant STR Inc., the supply of hotel rooms at the end of October 2013 was 755,005 rooms, a 10.2 percent increase over the pre-recession inventory at the end of 2007. Yet despite the increase in supply, occupancy has increased by eight percent during the same period and the average daily rate is up more than 15 percent to $112.89. And the more important metric, Revenue per Average Room, has risen 24.7 percent to $76.55.

end announced a final extension of its option on the land. That extension included an agreement to allow Shell to begin demolition on the site in the first quarter. Throughout 2013, the increased activity behind the scenes created increased leaks of information about Shell's intentions, especially from Horseheads Corporation earnings calls. The extension seems to confirm that Shell is proceeding towards construction, although there will be no certainty of that until a green light is officially announced.

That announcement will be the tipping point in the expansion of confidence in the future of the economy. When it occurs, a decision to proceed for the cracker will spark a frenzy of real estate activity along the Airport Corridor and the Beaver Valley Expressway. While all of this activity will bring an extended period of new construction and employment to the region, little – if any – will have an impact in 2014.

The most likely prospect for the construction industry 12 months hence is that 2014 will have been a year of setting the table for the expansion of 2015 and beyond. The second half of the year should bring opportunities to build backlog and the certainty of improved conditions after 2014 should allow construction companies to persevere through another competitive year.

The 50 Percent Forecast

Most of the conditions described above are a product of the macroeconomic environment that we can see pretty clearly at this point, with few surprises likely. There are three variables, however, that could have enough impact on the regional economy that the forecast would improve significantly.

In descending order of likelihood, these three are: an early decision to proceed on the ethane cracker by Shell; an acceleration of the planning for highway work that moves most of the available funding from Act 89 to the contract stage in 2014; and acceleration in the rate of growth of the U. S. economy to more than three percent, which will trigger unexpected hiring.

While the odds of any of these happening are better than 50/50, the likelihood of all three is slim; nevertheless the occurrence of one or two – particularly if it is an early year green light for the Shell cracker – will lead to a noticeably better 2014 for the construction industry.

The Shell decision will boost regional confidence and will begin an extended period of investment in construction in Western PA. Much of that investment will come from outside the region so there will be some challenges that will arise, but overall the announcement is likely to add more than a billion dollars in additional construction annually for the foreseeable future. The most realistic impact of such an announcement in 2014 will be emotional rather than bricks and mortar. A decision to proceed will mean a rush to find land along the I-376 corridor but the construction impact will be from the work needed to decommission and demolish the Horseheads facilities. Given the amount of preconstruction activity that has been quietly taking place, work could start within six months of a decision to proceed if the regulatory approvals are secured.

PennDOT and the Turnpike Commission have demonstrated the capacity to push projects ahead during the implementation of the American Recovery and Reinvestment Act of 2009. Each has a long-term planning process that would enable acceleration of 2015 projects into the coming year but there is some question as to whether enough design has been done to allow such acceleration in 2014. The heavy/highway segment of the industry stands to gain 20 percent or more in volume if the state can move projects up.

The 20 Percent Forecast

On the other side of the coin from the unexpected good fortune that would result from a few positive developments, there are a few potential issues that could kill whatever prospects exist for improvement in 2014.

The most likely of these would be a regression in the pace of recovery of the overall economy. Many of the economists who are speculating that the pace of growth will gain steam in 2014 are basing that forecast on an improving global economy, particularly in Europe. While there is some support for the idea that Europe has turned the corner, the economy in the Eurozone is still fragile and dependent upon the strength of a few countries.

The construction industry felt pain in 2013 from the slowdown in hospital/healthcare projects. The ongoing battle between UPMC and Highmark also cost millions that could have gone for bricks and mortar projects. The pressures on both the healthcare giants aren't going to lessen in 2014. Should revenues become negative to expenses the impact on construction will be even greater.

Despite the previously stated rationale for the construction of an ethane cracker in Western PA, the size of the investment and Shell's conservative management could shelve the project. Such a decision wouldn't spell doom for the gas industry's expansion in Pittsburgh, but it would slow the development of the downstream activities until another cracker was located here. Gas exploration will continue to ramp up and even at conservative growth rates, the need for upstream and midstream projects and the related industry's construction will be there.

The more serious damage that would result from a no go from Shell would be felt in the deflation of confidence in the regional economy. BG

NATIONAL MARKET UPDATE

The PNC Financial Services Group's outlook for the November/December period was one of many that see more favorable economic conditions ahead in 2014. While not predicting anything close to robust growth, PNC economists expect an improved start to 2014 because of higher consumer spending at the holidays and continued favorable borrowing conditions.

Downplaying consumer polls, PNC predicted an increase in holiday spending "because two million more people have jobs, stock prices are up nearly 25 percent, house prices are up by more than 10 percent, and gasoline prices are lower by 15 to 20 cents per gallon (saving consumers over $2.5 billion) during this upcoming holiday season compared to one year ago."

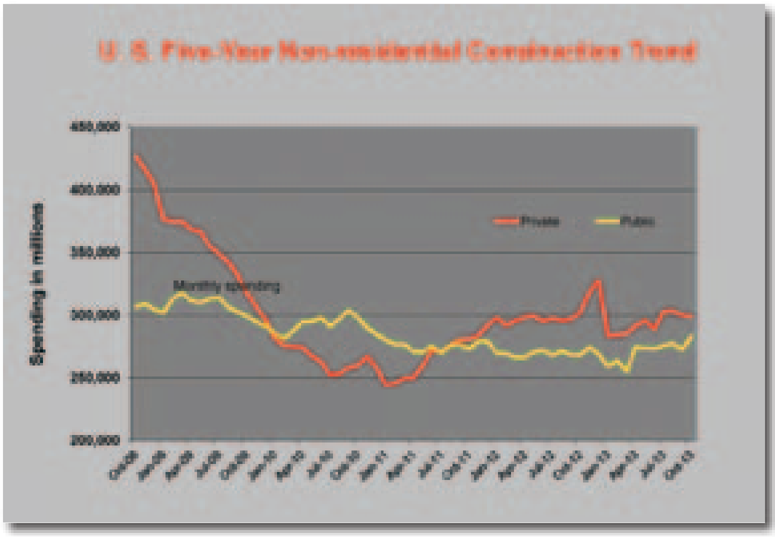
Among other highlights in the *Outlook*, PNC forecasts unemployment to fall to 6.5 percent by the end of 2014, noting at the same time that it did not expect that to trigger an increase in interest rates until unemployment fell to 6.0 percent. In fact, the forecast for the bellwether ten-year Treasury is below 3.5 percent in 2014. PNC economists expect GDP to be more consistent but remain at 2.5 percent in 2014 and consumer inflation to be two percent. Their prediction of incoming Federal Reserve Chair Janet Yellen is for a gradual tapering of the $85 billion monthly bond purchase program that will end as 2014 closes.

A surprising number of analysts – and even a couple of Federal Reserve presidents – are pointing to more even robust growth in 2014 than the economists at PNC. While there is hardly unison on the reasons behind the more optimistic outlook, the improved pace of hiring, increased consumer spending on durable goods and the depletion of the housing inventory overhang are noted as signals of growth above three percent. Several are pointing to a stronger European market as well. Such improvement in the Eurozone would be welcome news in China and India, which in turn would benefit U. S. exports.

The recovery in Europe is hardly a sure thing, however. While austerity has worked to dial back the crises in the member nations with fiscal woes, like Italy, Greece and Spain, the health of the economies there is only marginally better. And although there seems to be better prospects for Germany and France businesses, the boogeyman in 2014 will be politics rather than sovereign debt.

Germany's Angela Merkel was re-elected chancellor on December 17 but her victory required an uneasy coalition-building between her Christian Democrats and the Social Democratic party. The resulting government will likely focus more on issues like a national minimum wage and greater integration with the European Union and less on pro-business issues.

In May 2014, the European Parliament has its elections and the litany of Euro problems of the past three years – high unemployment, spiraling debt, austerity, German surpluses and the growing friction with America – has fueled the rise of alternative party candidates. Optimism about Europe's recovery rests on the ability of the current leadership of the European Union to weather challenges from alternative politics and for the businesses and consumers in the more prosperous nations to begin to spend more. Any increased demand from the EU will make a small contribution to U. S. growth.



Private investment in nonresidential structures rose 12 percent for the quarter and 18 percent year-over-year.

It has been politics in the U. S. that have added a level of unnecessary uncertainty to the economic outlook. Assum-

...the consensus final forecast for new residential construction remains below one million units for 2013 and only crosses the 1.5 million mark again in 2015...

ing that the deal done to end the government shutdown in October does not lead to another in the first quarter, the loss in fourth quarter gross domestic product – which economists expect to be about half percent – should be recaptured in the January-to-March 2014 period. With hiring continuing to improve at a rate that is faster than expected, a more robust beginning to 2014 would set the table for higher growth.

Real GDP increased a surprising 4.1 percent in the third quarter, up from 2.5 percent in the second quarter, the Bureau of Economic Analysis reported on December 20.

	Fannie Mae	Freddie Mac	Moody's Analytics	MBA	NAHB	NAR	S&P	Wells Fargo	Zelman & Assoc.	Consensus (average)
2013	.93	.95	.98	.92	.92	.98	.94	.96	.97	.95 (+22%)
2014	1.21	1.20	1.51	1.04	1.15	1.28	1.23	1.14	1.20	1.22 (28%)
2015	NA	NA	2.01	NA	1.52	NA	NA	1.30	1.45	1.57 (+29%)
Forecast Date	*Sep-13*	*Sep-13*	*Sep-13*	*Aug-13*	*Sep-13*	*Sep-13*	*Aug-13*	*Sep-13*	*Aug-13*	

The consensus forecast of nine national entities involved in housing expects new construction to grow by more than 25 percent over the next two years. Source: 2014 Outlook: Emerging Opportunities for Construction.

Analysts cited a number of reasons for the higher growth but most pointed to unusual inventory building as the main driver, suggesting that without higher consumption, there will be an 'echo' decline in quarter four. While there is historical backup for that theory, it is also possible that observers are unwilling to concede a more robust economy at this point.

Private investment in nonresidential structures rose 12 percent for the quarter and 18 percent year-over-year. Residential investment increased 14 percent and 15 percent, respectively. Government investment in structures jumped 6.7 percent. Federal spending on structures fell in the third quarter but state and local government investment in structures rose 7.2 percent. While fourth quarter GDP is expected to decline due to the shutdown, growth over two percent would set the table for 2014.

Government data also showed a steeper decline in first time unemployment applications and a stronger hiring in November. The Labor Department reported 203,000 new jobs in November, the third month in the past four that exceeded the 200,000-job level. Unemployment also dropped to seven percent. The lion's share of the change in unemployment came from government workers returning to their jobs after the shutdown; however, the report also showed a surprising increase in the number of civilians working in November, with a 63 percent labor participation rate.

These data suggest that real economic recovery is underway. Some of the construction industry's leading economists see signs of that recovery trickling down.

The chief economist of the American Institute of Architects sees the trend in billings in architects' offices as a reinforcement of the improvement to come. Dr. Kermit Baker notes that although the November survey of architects showed a decline from October to 49.8, the Architectural Billings Index (ABI) has shown increased billings for an extended period.

"The [Architectural Billings Index] has been positive for 12 of the past 13 months, which is very positive for 2014 and into 2015," he explains. "All regions of the U. S. are also now seeing above 50."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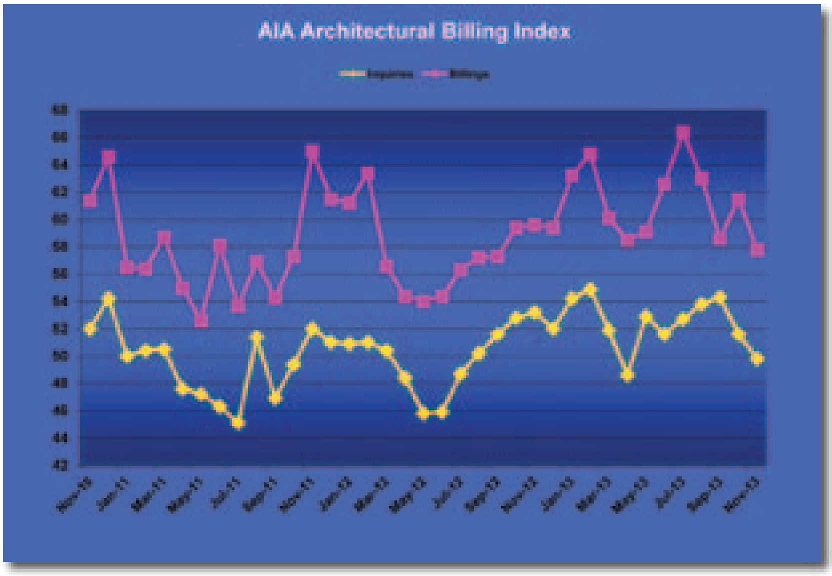


Baker predicts that construction growth in 2014 will be in the high single-digits. The AGC's chief economist, Dr. Kenneth Simonson, is forecasting increases in construction of a similar magnitude for 2014 and the next few years. Simonson expects gains of six-to-ten percent to be driven by the effects of what he calls "shale gale" – the robust growth in shale gas exploration in multiple regions – and the "residential revival" underway. He sees single-family construction slowing but the demand for multi-family apartments continuing past 2014. Simonson sees potential drags on construction from the continued government budget issues, the rapid growth in online shopping to cool off retail and the decline in office space needed per employee.

Even with these potential limiting factors, the current construction activity reflects the continued recovery from the recession and the under-building that followed. Both office and retail vacancy rates continue to decline. The supply/demand dynamics for commercial real estate are still supportive for increased construction.

In the multi-family category it is unexpected demand that is pushing rents and new construction higher, even as single family prices rebound and the overhanging inventories shrink. During past housing cycles such a rebound in home values spurred more buying and new construction; however, the rate of household formations is currently working against the need for new home construction.

Growth of renters has outpaced that of buyers since the 2006-2007 housing market peak. After reaching 1.5 million new homeowners during the 2004-2005 period, the growth of home ownership declined precipitously, with home ownership actually declining since 2008. During that same period the number of renters spiked, adding more than 500,000 new renters during the recession and then more than 750,000 new renting households annually since 2010. The number of new household formations – regardless of whether from renters or buyers – has remained below one million since the housing bubble burst, even though net population growth has averaged about three million people each of those years.

For these reasons, the consensus final forecast for new residential construction remains below one million units for 2013 and only crosses the 1.5 million mark again in 2015, nearly a decade after that level was last seen during the housing boom.

One significant factor that had been holding back the housing market showed continued improvement in November. Zillow Inc. reported that the percentage of homes with mortgages that had negative equity dropped to 21 percent from 23.8 percent in the second quarter. The share of owners with at least 20 percent equity climbed to 60.8 percent from 58.1 percent, making it easier for them to list properties and buy a new place. Continued price appreciation should boost the numbers of 'move up' buyers, one of the key consumers of new construction.

Another potential source of demand for new homes that exists is the so-called 'boomerang buyer.' These buyers would be homeowners who went through foreclosure or sold to deleverage after the housing crisis and are poised to return to the market. That cohort numbers in the millions of households but what is unknown is the share that are both willing and qualified to finance a home again.

The nation's homebuilders seem to be seeing improved conditions as well. The Housing Market Index compiled by the National Association of Home Builders (NAHB) was at 54 in November. This marked the sixth consecutive month that more home builders viewed market conditions as good rather than poor.

A surge in public construction spending in October pushed total construction higher than any month since May 2009. Public construction spending increased 3.9 percent for the month but year-to-date totals lagged 2012 by 2.8 percent. Within the total public outlay, heavy and highway construction increased 0.6 percent in October and 0.3 percent year-to-date. Educational projects jumped 8.5 percent for the month but were 8.5 percent lower than 2012 through the first ten months.

Total construction put in place in October totaled $908 billion, 0.8 percent higher than in September. The total for the first ten months of 2013 was five percent above the total for the same months in 2012. BG

WHAT'S IT COST?

Data released in mid-December bore out the impact of reduced global demand and compression of margins on manufactured product prices in 2013, despite rising demand from a rebounding U. S. housing recovery. Only the deep recession in 2009 led to lower inflation in any year going as far back as 1956.

The Bureau of Labor Statistics reported on December 13 that the producer price index (PPI) for finished goods fell 0.5 percent, not seasonally adjusted, in November and rose 0.7 percent over the 12-month period. The PPI for inputs to construction—a weighted average of the cost of all materials used in construction plus items consumed by contractors—also dropped 0.5 percent for the month and rose 1.1 percent compared to November 2012. Given the trends in place, there should be little impact from December in the rate of inflation for the full 12 months of 2013.

The PPIs for inputs to different types of construction all declined for the month and increased only slightly year-over-year: residential, -0.3 percent and 1.5 percent respectively; commercial structures, -0.4 percent and 1.0 percent; total nonresidential, -0.6 percent and 0.7 percent; industrial structures, -0.4 percent and 0.6 percent; and other nonresidential, -0.8 percent and 0.5 percent.

Among the products and materials that showed year-over-year decreases were diesel fuel (-5.6 percent over 12 months); copper and brass mill shapes (-6.0 percent); aluminum mill shapes (-4.3 percent); and asphalt felt and coatings (-1.2 percent); steel mill products (-0.6 percent); architectural coatings (-1.0 percent); and plastic construction products (-1.0 percent). Three indexes that showed significant increases in price for the 12 months were gypsum products, up 14 percent; insulation materials, up 8.2 percent; and lumber and plywood, up 13 percent.

PPIs for new nonresidential construction and for subcontractors all rose year-over-year: offices and warehouses, both up at least 2.7 percent over 12 months; health care construction, up 3.0 percent; schools, up 3.3 percent; and industrial buildings, up 4.1 percent. Inflation for nonresidential plumbing contractors rose 4.3 percent; concrete contractors, 2.9 percent; electrical contractors, 1.8 percent; and roofing contractors, 1.3 percent.

Continued recovery in the U. S. housing market should create more demand for the products that showed increases in 2013 but the rate of new construction is not forecasted to be robust again until 2015, meaning that inflation for construction materials should be within a point or two of the overall PPI in 2014. BG

PERCENTAGE CHANGES IN COSTS	Nov. 2013 compared to			
	1 mo.	3 mo.	1 yr.	10 yrs.
Consumer, Producer & Construction Prices				
Consumer price index (CPI-U)	-0.3	0.0	1.0	26.7
Producer price index (PPI) for finished goods	-0.5	-1.1	0.7	35.6
PPI for construction	-0.5	-0.9	1.1	51.6
Costs by Construction Types/Subcontractors				
Residential buildings	-0.6	-1.2	0.7	N/A
New industrial building construction	0.1	2.0	4.1	N/A
New warehouse construction	0.9	0.4	2.9	N/A
New school construction	0.1	2.0	3.3	N/A
New office construction	0.0	1.5	2.7	N/A
New healthcare construction	-0.2	1.3	3.0	N/A
Concrete contractors, nonresidential	0.1	1.2	2.9	N/A
Roofing contractors, nonresidential	-0.6	0.2	1.3	N/A
Electrical contractors, nonresidential	0.0	0.2	1.8	N/A
Plumbing contractors, nonresidential	0.2	2.2	4.3	N/A
Costs for Specific Construction Inputs				
#2 diesel fuel	-3.9	-4.2	-5.6	211.5
Asphalt paving mixtures and blocks	-0.1	-0.2	1.1	125.7
Concrete products	0.1	0.3	2.7	43.7
Brick and structural clay tile	0.6	0.9	1.4	13.7
Plastic construction products	0.4	0.3	-1.0	49.4
Gypsum products	-1.6	-2.2	13.7	48.6
Lumber and plywood	1.4	4.3	12.9	11.2
Architectural coatings	0.1	-0.1	-1.0	68.3
Steel mill products	0.8	1.0	-0.6	74.8
Copper and brass mill shapes	-1.1	-1.2	-6.0	146.3
Aluminum mill shapes	0.0	-0.2	-4.3	18.6
Fabricated structural metal	0.0	0.8	3.4	49.4
Prefabricated metal buildings	0.1	1.7	1.9	92.5
Crude petroleum (domestic production)	-10.3	-14.5	0.9	210.8
Asphalt (at refinery)	-7.9	-8.7	-8.2	240.8
Cement	-0.4	0.7	4.6	33.0
Iron and steel scrap	5.8	3.7	3.2	131.1
Copper base scrap	-0.8	-0.3	-2.3	272.9

Source Bureau of Labor Statistics, Updated December 16, 2013

Compiled by Ken Simonson, AGC Chief Economist

THE BIG PICTURE: Confidence In 2014

Whether the coming year is going to set the table for increased construction activity or usher in a long-awaited boom in regional construction, there are several key issues and industries that will be bellwethers worth watching closely. The fundamental long-term outlook for a couple of these is quite bullish. Demographics and the positioning of Pittsburgh's healthcare providers indicate significant demand for more and better facilities for care of the sick and aging. Pennsylvania's bridges and highways are subject to

greater wear and tear because of the freeze/thaw cycles and ever increasing usage. Firms who serve that market can look at the prospects for more work and see that the demand for construction should not decline. Of course, both of these sectors – which provided plentiful business opportunities during the last business cycle – face significant head winds due to funding or government-related issues that will keep either sector from supporting construction gains in 2014.

It is hard to envision any single factor that will influence a change in the direction of 2014 more than the expansion of the natural gas industry. Already a significant factor in the regional economy, the gas industry faces some challenges of its own that should keep growth moderate over the next year or two; however, one development is the tipping point for the exploration and extraction of natural gas in the shale formations to shift into higher gear as the downstream potential of the commodity is tapped.

Even without a decision to proceed with the ethane crackers proposed for Monaca and Wood County WV, the growing market for liquefied natural gas is emerging as another driver for growth in the shale gas fields.

The Healthcare Headache

The healthcare industry is under pressure on several fronts at a time when demographics and patient lifestyle expectations could be ushering in an era of growth in services, The Baby Boomers – the most populous generation ever born in America – are entering retirement years and demanding medicine that will allow them to maintain the kinds of activities that Boomers have enjoyed all their lives. That appetite for care – coupled with medical research that can provide more solutions – is a great long-term recipe for growth, provided there is a way to pay for the care.

Affordable Care has the goal of expanding access to healthcare and creating a way for providers to be paid. It is not aimed at providing a way to expand the care that hospitals and doctors can give to those who have access through adequate current insurance. Healthcare reform – so called Obamacare - is partially funded by increases in taxes on individuals and employers. A greater share of the funding is drawn from fees charged to the pharmaceutical and health insurance industries. Moreover, reform is also paid for by decreasing the reimbursements allowed to healthcare providers.

Obamacare has added a burden of some size on businesses in and outside the healthcare industry. The difficulties in its rollout have also added to the costs of compliance for insurers and hospitals. With mid-term elections set for 2014 and many of the provisions of healthcare reform not set to be implemented until campaigning for the 2016 presidential election is underway, the future of Obamacare remains uncertain. For the coming year, however, it's clear that reform will continue to negatively impact the organizations that are involved with healthcare capital investment in the region.

"Healthcare reform has been very challenging to hospitals across the country. I don't think lawmakers completely understood what they were passing," says John Krolicki, UPMC's vice president of facilities and services. "It's making us be more efficient but it's not about how to do more for less; it's about how to do less for less."

Compounding the problems raised by healthcare reform is the ongoing unresolved dispute between UPMC and Highmark. The disagreement over the extension of a contract between the two healthcare providers/insurers past the end of 2014 has inspired lawsuits and counter lawsuits. Gov. Corbett and the state legislature have weighed in with calls for cooperation and proposed legislation that would require both systems to allow patients to be treated regardless of the insurer. The social and economic impact of the disagreement is debatable but the negative impact of the feud on construction is not.

When Highmark agreed to merge with what is now the Allegheny Health Network (AHN), experts estimated that the deferred maintenance and work needed to make the system's hospitals competitive would exceed a billion dollars. The industry looked forward to a boom in construction, primarily at Allegheny General, West Penn and Forbes Regional, but Highmark's management did not bring an end to the losses being suffered in the AHN hospitals. And while Highmark's then-CEO Ken Melani expressed a willingness to use some of the insurer's cash to invest in the hospitals, current CEO William Winkenwerder has been more cautious.

You only need to listen to Robert DeMichiei, UPMC's chief financial officer, address quarterly earnings to understand how the dispute has limited UPMC's investments. The healthcare system continues to show strong revenues in excess of expenses but its quarterly operating income has declined to approximately $50 million per quarter as a result of lower reimbursements, higher costs associated with the acquisition of doctors' practices and margin pressures in UPMC Health Plan business.

For much of the past decade, the capital budget for UPMC has been $250 to $300 million annually. That total did not always include the investments made in new facilities like the new Children's Hospital or UPMC East. The financial pressures described above have limited the expenditures in 2013 and 2014 by roughly half of the normal. Plans for the two-building $394 million Center for Innovative Science in Shadyside and the $75 million Energy Center at UPMC Mercy Hospital have been shelved. Projects like the expansion at UPMC East, new patient tower at Shadyside Hospital and the new Presbyterian University Hospital in Oakland have moved from a planning cycle to off the horizon.

"The large, major projects will most likely continue to be on hold," says Krolicki. "We'll be investing more on infrastructure and renovation than adding square footage." He says that among the bigger projects will be a multi-year upgrading of the nursing units at the Presbyterian-Shadyside campus, the completion of the demolition of the old Children's Hospital and preparation of Presbyterian Hospital for a future new tower and expansion of outpatient centers in the UPMC Passavant market. "We are starting to increase and you'll see more projects coming out now."

At Highmark, construction investment has also been in the $150 million range. Rather than implementing the construction program envisioned by Melani, Highmark will focus on providing the facilities needed at its existing hospitals, explains Alex Sciulli, senior vice president with Highmark corporate real estate services.

"We're not going to build a lot of new facilities but we'll upgrade what we have. There is not enough growth or demographics to justify new hospitals," he says. Sciulli says that instead of trying to match the hospitals that exist in the region, Highmark is trying to change the delivery model to make it more convenient for the patient.

"That's the purpose of the medical mall. You can go there to see your primary care physician, but also get blood work done, get physical therapy, go to a library to read up on your condition or maybe go to a demonstration kitchen to learn about better nutrition," Sciulli says. "It's a place where the patient can get more attention because the focus is on the patient." Such a delivery model is more efficient and cost effective for the provider.

Sciulli says that the construction program in 2014 will focus mostly on the seven hospitals within AHN. Aside from the continuation of the $100 million investment in Jefferson Hospital, most of the program will be smaller renovation projects. "That's subject to performance at the hospitals," he adds.

Infrastructure Relief

The week of November 18, 2013 was a roller coaster ride for the Commonwealth's government and the heavy/highway construction industry. The House of Representatives failed to pass House Bill 1060 – twice – on Monday, dashing hopes that the roads and bridges in Pennsylvania would get an additional $2.3 billion in funding over the next five years. On Wednesday, the House reversed itself and approved the bill. Thursday brought minor revisions from the state's Senate and by November 25, the governor had signed into law what is now known as Act 89 of 2013.

Act 89 removes the cap on the Oil Company Franchise Tax to replace the funding from the 12-cent per gallon retail gas tax on January 1, 2014. Funding will also come from higher fines and license and registration fees. The funding from the Act will create additional funds for transportation improvements and public transit. Although the coverage of the bill talked about its additional $2.3 billion in spending, that level doesn't arrive until 2018.

By the fifth year of the plan, the transportation package will include:

$1.3 billion annually for state roads and bridges
$480 million to $495 million annually for public transportation
$237 million annually for local roads and bridges
$144 million annually in a multi-modal fund
$30 million annually for dirt, gravel and low-volume roadways
$86 million annually for Pennsylvania Turnpike expansion projects

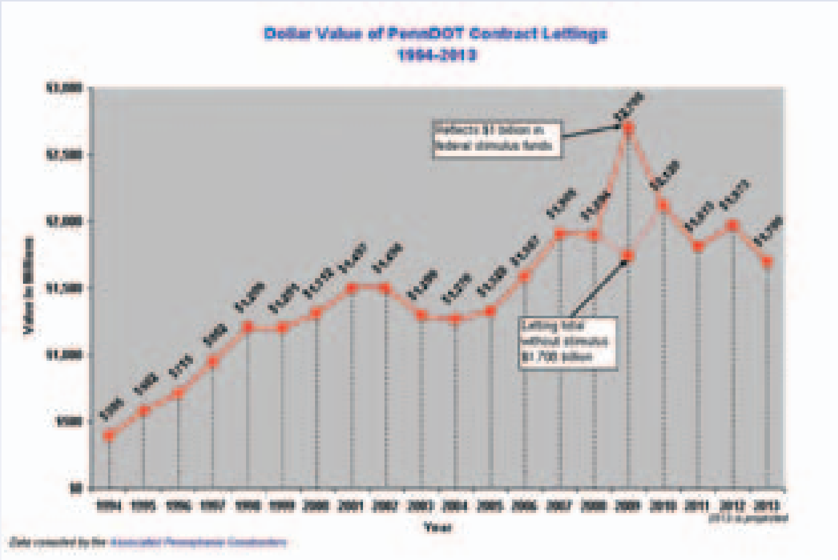
In the Pittsburgh area, the transportation bill will help fund the $34 million Birmingham Bridge reconstruction, $48 million Liberty Bridge repairs and $87 million pavement reconstruction and bridge preservation on eight miles of Interstate 376 in Allegheny County.

Act 89 is also important because it relieves the PA Turnpike from the annual $450 million contribution to PennDOT that was part of Act 44 of 2007. Within one month the Turnpike Commission's credit rating was upgraded and planning for repairs and expansion to the Turnpike system was underway. The latter development is critical to the health of the state's toll roads, thinks George Mezey, president of Trumbull Corp.

"They now know that Act 44 is coming to an end and can start to plan strategically. 2013 was the first year since I've been working at Trumbull – that's 27 years – that the Turnpike didn't have an expansion project of some sort going on," he says.

Dean Mosites, president of Mosites Construction, thinks that the immediate benefit of the transportation bill may be in the confidence it gives the owners.

"I get this feeling from talking with Brian Gilkey from our highway group," Mosites notes. "The sense was that PennDOT and the Turnpike Commission know what they want to do and can now design for that. They have money in their coffers but didn't have assurance of money coming in behind that."



As downtown Pittsburgh has seen resurgence, demand for public transportation has risen, even while service was curtailed. Surveys by the Pittsburgh Downtown Partnership show that more than half the workers employed in the Central Business District commute via public transit. Having transit options is important for businesses considering relocation to the CBD, says CBRE managing director Jeffrey Ackerman.

"It's one of the first questions companies considering Downtown ask," he relates.

For construction, the biggest source of work is still PennDOT and the jury is out on how ACT 89 will play out in 2014. Among the unknowns is how much work PennDOT has in late stages of design and how the market will react to any uptick in bidding.

Allegheny County's Port Authority Transit also gets a shot of confidence from Act 89, knowing that it has a steady stream of funding as a foundation for the next five years. The fiscal condition of PAT is weak enough that little or none of the additional funding will go to significant capital projects, but the boost allows for operations without further service cuts and may allow restoration of some routes that have been scrapped over the past few years. That's an improvement that has a ripple effect on other parts of the Pittsburgh region, especially the urban core.

"I'm cautiously optimistic. PennDOT talked about doing design on projects with an eye to the fact that there would be funding," observes Rich Barcaskey, executive director of Constructors Association of Western PA, the association of highway contractors. "Mum's the word right now – that's why I say I'm cautiously optimistic – although the January 16 letting has quite a number of additions to it."

Barcaskey points out that the 2013 season fell short of the $1.7 billion dollar plan, a schedule that is among the lowest volumes in more than a decade. He thinks perhaps some of the later work was held back to increase the activity in the early 2014 lettings.

Mezey also expects to see an increase in lettings initially but thinks there will be a lag following that while PennDOT figures out its priorities, a process he surprisingly thinks should be more deliberate.

"There will be tremendous pressure on PennDOT to do more work soon and splashy work," he says. "I would like to see them take time to plan for 2016 and 2017 but politics probably won't allow that."

One of Mezey's concerns is that the dwindling funding has reduced the share of PennDOT's work that has been for additional capacity. With the continual growth of traffic and population in Philadelphia and the resurgence of the Pittsburgh economy due to the natural gas business, the existing capacity isn't adequate but new capacity has been funded. "New capacity is two percent of PennDOT's budget compared with 20 percent in the past," he says.

One new capacity project that Act 89 helped assure is the $632 million Southern Beltway, a 13.3 mile new toll road extending the Findlay Connector at Route 22 near Starpointe to I-79 at a new interchange to be built between Bridgeville and Southpointe on the Allegheny/Washington County border. Planned well before the words 'shale gas' were in our vocabulary in Western PA, the Southern Beltway links the current home of the Marcellus Shale industry in Washington County to the location of its future expansion. The Turnpike Commission estimates that 30,000 cars will take the Beltway daily when it is completed. The new road will also act as a needed relief valve for the growing congestion on the Parkway West that begins at the I-79 interchange.

Aside from the traffic improvements and ease of movement between Southpointe and the airport, the Southern Beltway will be a catalyst for development in the west, both in Washington and Allegheny County.

A Year of Decision for Shale Gas

The business community and media have had less than five years to learn about the natural gas industry and how it operates, so the somewhat boring news year that 2013 was in the energy business made Western Pennsylvanians a little leery of the gas industry's prospects.

Like most asset-heavy commodity businesses, gas exploration is sensitive to changes in supply and demand and its success or failure is directly related to the price of the commodity compared to the cost of acquiring it. Over the time that the Marcellus Shale formation has been explored, the price has remained relatively stable and very low. That means that the costs associated with securing the land assets and drilling have been the main variable.

During the proving stage of the Marcellus play – and later the Utica Shale play – the exploration and expansion was done by the small independent producers. These companies are leaner, with much lower overhead structures and often less rigorous safety procedures, which means that their drilling costs are lower. Once the shale play was proven out – as it was in the Marcellus a few years ago – the large global super major producers moved in, buying up the independents and their assets.

Major producers – Exxon Mobile, Royal Dutch Shell, BP, Chevron – are not particularly nimble, nor are they the risk takers that the independents are. Decisions by these global producers are made with greater deliberation. In a time of price pressure and lower profits like 2013, decisions to deploy billions in capital can stretch out over years instead of months.

Perhaps because the growth of the industry was less obvious in 2013, the gas industry's two signature projects were the subject of several headlines and back channel discussions suggesting problems ahead.

PERHAPS BECAUSE THE GROWTH OF THE INDUSTRY WAS LESS OBVIOUS IN 2013, THE GAS INDUSTRY'S TWO SIGNATURE PROJECTS WERE THE SUBJECT OF SEVERAL HEADLINES AND BACK CHANNEL DISCUSSIONS SUGGESTING PROBLEMS AHEAD.

The Wall Street Journal wrote an article in October speculating that the expansion of the pipeline infrastructure would eliminate the need for a cracker in the Appalachian region. Industry experts describe the pipeline infrastructure in the Marcellus as constrained, however, and what is being added is designed to serve the region, not pipe Marcellus or Utica gas to the Gulf. The November announcement of a second cracker planned for the region in Wood County, WV seemed to render that speculation null and void.

Throughout the late summer and fall, there were also whispers that the multinational energy companies – more specifically Chevron – were unable to make money in the Marcellus and Utica exploration. Reports of high drilling and operating costs even suggested that one or more of those big players would withdraw from the play in the Appalachian. Chevron's delay in starting its regional headquarters added fuel to such speculation; however, it's not a reflection on the region's prospects as much as the delay reflects Chevron's deliberative approach.

Regardless of Chevron's relative profitability – or any of the majors for that matter – the data shows that production in the Marcellus continues to climb. Range Resources reported in mid-December that its production in the Marcellus had crossed the billion cubic feet per day milestone. The December 2013 report by the Energy Information Administration (EIA) showed that the drilling of new wells was more than offsetting the decline in production from older wells.

Moreover, the EIA's report estimated that the potential output from Marcellus Shale drilling was above 2,200 trillion cubic feet, a supply that would last another 92 years unless additional applications for natural gas emerged. With that kind of horizon, it's no wonder that the major players in energy aren't concerned about extending a decision period for a year or two.

A lot has been made of the due diligence Shell has done to ensure that there is adequate supply of ethane from gas exploration in the Marcellus and Utica formations. This has led to wildly varying reports of disappointing output and an oversupply of ethane at the same time. Clearly, both of these scenarios can't exist at the same time. It may be just as important to look at the business case the way most entrepreneurs would: will there be enough customers to buy the output from the cracker?

One of the industries that will be the main customers for the ethylene produced there is booming and champing at the bit to grow further. According to the Year-End 2013 Chemical Industry Situation and Outlook, published by the American Chemistry Council (ACC), favorable oil-to-gas price ratios are making the U. S. the most attractive place to invest in chemical manufacturing. The low raw material price has reversed a long-term trend for U. S. manufacturers, shifting them to among the lowest cost producers in the world.

As a result, exports are surging. The industry has gone from a trade deficit to a surplus that is expected to be about $3 billion in 2013. By 2018 that surplus is forecast to reach nearly $30 billion, with almost $300 billion in exports.

"American chemistry is back in the game," Kevin Swift, ACC's chief economist said in introducing the annual report. "After a decade of lost competitiveness, American chemistry is reemerging as a growth industry. We're seeing growing end-use markets; strengthening employment; surging exports; and an influx of tremendous capital investment. Put simply, the U. S. is now the most attractive place in the world to invest in chemical manufacturing."

Over the next five years, production is expected to grow by almost 25 percent, pushing industry shipments to $1 trillion by 2018. To keep pace with the growth prospects, capital spending from chemical manufacturers has increased by double digits annually since 2010. The ACC forecasts that domestic investment between now and 2018 will top $60 billion.

Liquefied natural gas (LNG) is an energy source with demand from overseas that is growing rapidly. LNG is coveted in Europe and Japan as a clean and safe alternative to the nuclear power that the countries invested in building decades earlier. Prices for LNG for export are roughly double those of the domestic buyers of natural gas, creating a strong incentive for more gas to be liquefied and exported. The EIA's recent report on LNG shows an industry at the beginning of its life cycle. Exporting LNG would help to stabilize gas prices overall and reduce volatility for consumers.

The EIA sees the U. S. becoming a net LNG exporter in 2016 as new projects come online with shipments reaching 3.4 billion cubic feet per day by 2025 and 5.8 billion cubic feet by 2040. The report forecasts three percent annual growth in LNG during the first ten years of net exports.

That forecast represents a 160 percent increase in the EIA's outlook for 2014 compared to the one from a year ago. The faster pace of growth is supported by increased use of LNG in markets outside North America, strong domestic production, and low U.S. natural gas prices relative to other global markets.

Cabot Oil & Gas' production from the northeastern Pennsylvania corner of the Marcellus Shale has shot up 50 percent over the past year, in part due to a new LNG supply contract reported by the company on December 19. The Houston-based producer signed a 20-year agreement with Japanese trading company Sumitomo for

350,000 million cubic feet per day to be liquefied and shipped from Dominion's Cove Point Terminal in Maryland on the Chesapeake Bay.

Joy Ruff, community outreach director for the Marcellus Shale Coalition, points to LNG export as one of the industry's key future markets and says that Pennsylvania has lost ground to Maryland in the area of infrastructure.

"Sadly for Pennsylvania, we have neglected our shipping infrastructure and locks and dams," she explains. "Baltimore has not, which is why that is where most of the coal from Pennsylvania is shipped. That will be an advantage for shipping LNG. We're seeing some movement to rebuild. We've seen it already with the railroads."

Ruff, in fact, encourages observers of the gas industry to focus on where investment is being made to gauge what is going on in the business. She points to a Gas Business Briefing study that showed the Marcellus/Utica Shale area with the largest amount of investment in the 'other' category, meaning capital investment that is not in land or merger/acquisitions. But she also sounds a cautionary note.

"A recent survey of oil/gas executives about where investments are the most stable within the U. S. ranked Texas and Oklahoma most favorable," she notes. "Pennsylvania was less favorable because of the uncertainty regarding the regulatory environment. If you look at New York or the Delaware Valley in PA, the moratorium caused companies to pull out."

While she doesn't expect anything like that to occur in Western PA, Ruff says, "I think 2014 will be a watch year for regulation in a low price and pipeline constrained environment. If regulations step up or there are new taxes then we may have companies move out."

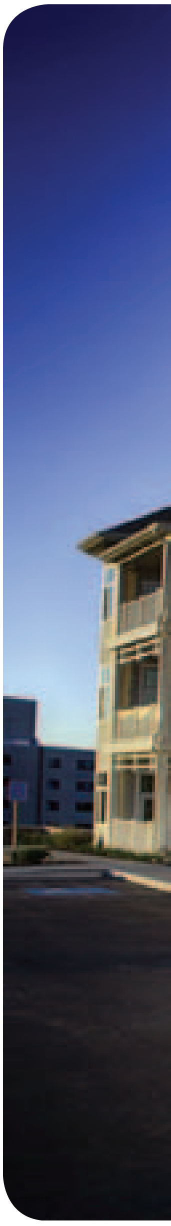
The decision by the PA Supreme Court on December 18 that ruled much of Act 13 – the state's drilling law – was unconstitutional added to concerns that producers may have about Pennsylvania as key regulatory decisions about drilling will now revert back to the myriad municipal jurisdictions. Observers of the gas industry still feel that the size of the Marcellus and Utica formations will ultimately make the play worth dealing with the more invasive regulations that Pennsylvania may impose. And they feel that the investments in establishing the downstream opportunities for natural gas will ramp up soon.

"Shell is feeling pressure from West Virginia from the other proposed cracker and from the other super majors looking to build out other gas-to-liquids capacity," notes Ruff. BG

Overbrook Pointe
Independent Living Center

Laura Deklewa, president of Allegheny Construction Group, developed a passion for the care of older adults and seniors during the time that she cared for her parents at the end of their lives. She was impressed by the care that her mother and father received from Lutheran Senior Life while they lived at St. John Specialty Care Center in Mars, PA. After their passing, Deklewa looked for a way to help serve other older adults and volunteered to help Lutheran Senior Life in its mission, eventually ending up on its board of directors.

During her service on the board, Lutheran Senior Life undertook a capital program aimed at meeting the changing needs of older adults. As that program unfolded, Laura Deklewa was presented an opportunity for her company to have a lasting impact on St. John.



The planning for the Overbrook Pointe project began well before the design of the facility. Architect Burt Hill had done the previous major addition to the St. John center in 1987 and was interviewed in late 2006 when Lutheran Senior Life intended to hire a firm to do master planning for the Mars campus and to design a product type that Lutheran Senior Life had already identified as needed, an Alzheimer's/assisted living facility. That project turned out to be the RoseCrest facility.

David Fenoglietto brought a vision for creating a continuum of care campus at the St. John home when he was hired as president and CEO. The capital program that was being planned meant to flesh out that vision of a Continuing Care Retirement Community (CCRC) with buildings that provided a rich lifestyle at St. John, while assuring care throughout aging.

"This was to be a two-part program to change the complexion of the campus to serve older adults in new ways. We refer to it as a contemporary model," explains Fenoglietto. That contemporary model he speaks of focuses on fostering connections between the residents and the community outside of the campus, a concept Fenoglietto calls "porous walls." "It's not about warehousing older adults but rather providing access to outdoor space, transportation, churches and shopping."

That concept drove the programming of the two buildings. Although there was an identified need for assisted living with memory care, the thinking about the project included planning for an independent living center as well. The idea that the new facilities should have porous walls – figuratively of course – helped guide the site selection. Rather than creating a sense of withdrawal at this new phase of St. John, the site was intended to connect with Route 228, the main road linking Mars to Cranberry Township and the major interstate highways.

Photo by Robert Borkoski Design

"Burt Hill did a study of sites – which were topographically challenged – and performed a facility assessment," says Tom Grden, the project architect. "We created a hierarchy of sites." Grden says that the solution resulted in RoseCrest and Overbrook being planned for adjacent sites that took advantage of elevation to give the residents great views. The site selection led to one of the project's defining challenges, however.

The portion of the St. John property chosen lay in two municipalities. RoseCrest was planned for a site in the borough of Mars, while the adjacent Overbrook building was in Adams Township. That meant that the entitlement, utilities and other municipal approvals had to involve two different processes.

During the design and preconstruction process for the RoseCrest Assisted Living center, Laura Deklewa offered the services of her company to budget the project as it developed. Her husband, Dick Deklewa and their estimators treated the estimate as though they were building the project. As the project got closer to construction, however, Dick viewed RoseCrest with less enthusiasm. The project was slated to be bid to a group of general contractors that were of varied size and business approach, and when the invitation to bid came, Deklewa decided that it wouldn't be productive for Allegheny Construction Group to respond.

Before the RoseCrest project proceeded very far the successful contractor pulled off the job and closed its doors. Lutheran Senior Life found itself in a tight spot, with fundraising in full swing and turned to Allegheny Construction Group to help get the project back on track. Allegheny was able to pull the subcontracting team together and the assisted living facility was completed on time and on budget. Under the original plan, the design and construction team was expected to complete the documents and pricing on the independent living apartments, Overbrook Pointe, six months later. While construction was being done on RoseCrest, however, the world fell into a deep recession. Lutheran Senior Life's leadership decided to hold off on Overbrook.

"Part of the decision was the recession and part was going to the township to get approvals for the whole parcel," explains Fenoglietto. "We started RoseCrest and then the slowdown hit in 2008 and 2009. We said, let's slow down and start construction after the stock market comes back."

The break turned out to be almost three years. During that time there were some design changes that were necessary because of code changes that effected accessibility and some of the mechanical design. Thought was given to making the apartments smaller to ease pressure on the budget but Lutheran Senior Life decided that the demands of the market didn't allow for downsizing; however, the overall elements of the architecture were unaffected.

"We started out on the path of using residential vernacular that was not commonplace. We didn't want it to look like it came from a home center," notes Grden, who remained the project's architect even after Burt Hill's merger with Stantec in 2010. "[Overbrook] was to be a residential-feeling environment that wasn't run of the mill but would be recognizable as residential in the Craftsman style."

Grden explains that his experience doing adaptive re-use of schools for residential shaped his ideas for multi-residential buildings and matched up with design elements of the Craftsman style – like large windows, high ceilings, big spaces and liberal use of millwork. Craftsman homes also reached their peak of new construction in the early decades of the 20th Century, meaning it would have been a popular home style when the older residents of St. John were growing up. He tells how the styling and the interior design work to separate Overbrook and RoseCrest from more institutional settings of the same purpose.

"The exterior is composite siding and shingles with white PVC trim board that doesn't need painting. We used trim to create artificial details that replicate the overhangs from the Craftsman style," says Grden. "In the interior I wanted to avoid having long corridors. The common areas have trim and stain from the Craftsman style. We use fireplaces as congregating areas with windows and balconies at those seating areas. These are at the elevators to foster a sense of community on each floor."

Visitors get a sense of what the building is like from the entrance. You can see the dining area and residential corridors from the lobby. The finishes and styling in the corridors are very similar to those in the apartments. "We want the sense of everyone to be that this is my home," Grden says.

"Our philosophy is to bring to the design what you would see at home," says Rocco Mastrangelo, corporate director of construction and facility management for Lutheran Senior Life. "The whole industry has been changing to modernize. People are looking for more of a home setting than an institution."

By the time the Overbrook project started, some of the more difficult challenges of the site had been overcome. From the access road at Pittsburgh Street to the top of the site was a change in elevation of 100 feet. PennDOT took a 40 foot easement on the property and the township ordinance required creating a parallel access road to the building. There was a high-pressure gas main parallel to the site and an endangered stream at the bottom of the hill where storm water would drain during and after construction.

The project team used the infringements of the gas line and the access road as an opportunity to set the building back in a buffer. They also designed bio-retention areas to divert the storm water away from the ponds. (That storm water solution designed by Stantec's David Hornicak has been used by PA's Department of Environmental Protection as a case study in green design.) And the layout of the two buildings allowed for the dirt taken from the significant cut of the hillside during the RoseCrest site prep to be used as fill to prepare the pad for Overbrook.

Trim on the exterior mimicked Craftsman-style architecture. Photo by Stantec.

Construction got underway on Overbrook in February 2012. The building was a 98,000 square foot structure with underground parking. Overbrook included 53 apartments, a mix of one- and two-bedroom units with two bathrooms. Rents are roughly $1,900 per month, with larger units that include a den with fireplace and a parking space running $3,000.

Although there were several years of waiting to start the Overbrook Pointe project, construction got behind schedule from the start because of some unforeseen conditions above and below ground.

"The schedule was the main issue with the project. Last winter didn't help; obviously that was a struggle," explains John Probert, Allegheny's project manager. "We did the bulk of the outside work in the winter."

As the excavation got underway, contractors discovered what Probert calls 'blue rock,' a seam of dolomite or limestone that is especially hard. "On the bulk excavation they ended up being able to get through with a ripper and a giant excavator but when it came to the foundations we needed to use a hoe ram to get through the rock," he says.

As construction progressed to the interior work there were more challenges that arose from the logistics of the team. Aside from the fact that the ownership of the architect had changed since the original design, one of the value engineering solutions done during preconstruction was to have the mechanical/electrical delivered by design/build. Some of the cost-saving measures and the response to code changes required extraordinary co-

For Tom Grden, the Overbrook Pointe and RoseCrest project was a return to his roots, designing living spaces for older adults.

Common spaces were designed to feel like living rooms for the residents to gather. Photo by Stantec.

ordination among team members. It took extra meetings and attention to ensure that the issues were hashed through with all the parties involved.

One example of this was a code change that impacted how dryers were vented. The original design called for a central ventilation system that would remove the exhaust from all the individual stackable washer/dryer units in each apartment. By the time the mechanical contractor submitted its design, codes required that dryer vent pipes had to be within 35 lineal feet of the outside. Some of the apartments had the dryers located further from the outside vent and a relocation of the unit could have been necessary. The solution ultimately involved installing vent fans within the central exhaust system. Getting to that solution took a little extra persuading, especially since Stantec's architectural design was being impacted by mechanical or electrical system issues that it did not control.

"We had to keep the team together and focused on what we were building," points out Mastrangelo. "It created havoc with the design and the coordination of subs to make sure that everyone had the scope of work. But the times the team had to come together to solve a problem they really worked well."

Whatever setbacks impacted the project's schedule in the early stages were eventually overcome during the balance of the construction. Work was completed in August 2013 and the doors opened on September 16. David Fenoglietto reports that nearly half the apartments are leased and that the design is attracting visitors from as far away as Florida.

"We want to attract a consumer that still lives an abundant life. We need to provide a product that matches that lifestyle," observes Fenoglietto. "Architecture is a key component to attract residents but so are the wrap-around services provided."

For Tom Grden, the Overbrook Pointe and RoseCrest project was a return to his roots, designing living spaces for older adults. He says that one of Stantec's slogans is 'creating communities' and thinks that designing a building that creates a community is an opportunity that every architect should find exciting.

"I really have to credit the [Lutheran Senior Life] organization for their interest, without which the project couldn't have happened," he says. "It's the working together that gives physical form and makes it possible for architecture to serve its higher purpose."

"We wanted to create the greatest value we could in the market, at a price that would attract residents," says Fenoglietto. "I think we have succeeded. Residents are moving in." BG

PROJECT TEAM

Lutheran Senior Life	Owner
Allegheny Construction Group	General Contractor
Stantec	Architect/Engineer
Marsa Inc.	Masonry Contractor
Stringert Inc.	Roofing Contractor
Montgomery Truss Co.	Roof Truss Contractor
Easley & Rivers Inc.	Interiors Contractor
Keystone Electric Inc.	Electrical Contractor
Ryco Plumbing	Plumbing Contractor
J. A. Sauer Inc.	HVAC Contractor
Wright Flooring	Flooring Contractor

TOM BROWN, INC.
Specialty Construction Products
Since 1936

Tom Brown Inc.

By Deborah Knox

It all started as the James Brown Company in1903, a small shop on Pittsburgh's North Side that sold hay, grain, feed, paints, and a few construction products. Fast forward to 2013, and four generations later, and Tom Brown, Inc. converts and distributes a full line of foam sealing and attachment tapes, together with caulking, sealant, restoration and repair products, along with tools and accessories. Their products are used in general construction, window manufacturing, truck, trailer and railcars, and on roads and bridges. "We sell to anybody that's keeping air, light or water out of any type of structure," says Kenny Brown, the company's president.

When Founder James Brown died in 1910, Kenny's grandfather Tom was only 13 years old and he took over the business. A fire destroyed that business in 1915, but Tom regrouped and re-established Tom Brown Builders Supply in Lawrenceville in 1936. He was already selling lime to area steel mills – an essential ingredient. Then, as a natural offshoot of that business, he started selling the by-product which was building lime. From that humble beginning, the company has evolved over the last 77 years into a full service caulking and sealants distributor and converter.

> Early in his career, back when they were just selling precast supplies, a salesman gave Kenny some samples of GE silicone and recommended that he sell it. It was immediately successful. "There was a clear demand so I started offering lines of products from 3M," he explained. "From there, we've continued to broaden the reach of the products and how they are applied. Our manufacturers keep doing things differently, and so do the contractors - so we keep pace."

Tom Brown, Inc. was located in Castle Shannon from 1955 until 2000 when they built their current facility in Lawrence, Washington County. For the construction, all local trades and as many locally sourced materials were used as possible, along with Traco windows (now a division of Kawneer) and Centria roofing. Now, they're installing very modern-looking modular offices with lots of windows and bold details. The 30,000 square foot building is in a bucolic area, overlooking Valley Brook Country Club, with sweeping views. It's a five minute drive from I-79 and 20 minutes from downtown Pittsburgh.

Kenny Brown, the third-generation owner of Tom Brown, Inc., and his son Brendan have continued to grow and develop the business. His brother Tom, owner of Tom Brown Contracting, Inc. is also located on the site.

Kenny started out in the trades and said he "worked a lot of boots on the ground hours" to learn the craft. He started working at the company 36 years ago at age 22 – right after graduating from Lafayette College with a degree in economics. There were six staff members then. He said it was really tough, and they only sold precast products, but it's where he wanted to be. "I knew I was coming to work here from the time I was a little kid."

Early in his career, back when they were just selling precast supplies, a salesman gave Kenny some samples of GE silicone and recommended that he sell it. It was immediately successful. "There was a clear demand so I started offering lines of products from 3M," he explained. "From there, we've continued to broaden the reach of the products and how they are applied. Our manufacturers keep doing things differently, and so do the contractors - so we keep pace."

Under Mr. Brown's leadership, the company has developed into a specialty product provider of sealants, tapes and that has the added benefit of the ability to slit, laminate, spool and die cut products to serve the many industries they serve.

The big revolution was in 2000 when Kenny established a machine shop on site to process and customize many of the foams and tapes they sell. "The best way for us to help our customers was to buy the equipment and process it ourselves," said Kenny. Having the customization capabilities in-house saves the company and its customers, both time and money.

He added "I didn't want people to buy more than they needed" and he needed to buy in bulk. The foam logs typically had 40 rolls of adhesive, but the client only needed, say, 12, and they had to be cut or prepared. When they sent products out, it would take two to six weeks for processing and he had a lot of leftover product. Also, sending out tape for window installations added a 15-day lead time, with associated costs.

It's a stark contrast from the peace and tranquility of the offices to the whirl of machines and oldies music playing in the machine shop that adjoins the warehouse. With doo-wop, Fleetwood Mac and Bon Jovi playing, six machinists prepare and process materials in four zones. The slitting machines make thin strips of adhesives, cutting widths as needed. They also have the capacity for laminating, spooling and die cutting products for customers. The spooling machines can bond and process materials into a 2,100-foot long roll. With laminating, they can add adhesive or PVC to one or both sides of foam products, or they can create multi-layer foams.

For the printing industry, they laminate a hard plastic on a foam wrap for the drums of printing plates to allow for smooth impressions when they're printing onto corrugated boxes.

The company is best known for their products supporting the window and curtainwall industries. They sell structural curtainwall glazing that is applied along with silicone, before the glass is installed. The silicone and tape are all that holds the glass in so a "stop" is not needed on the outside. Their customers in the region are primarily Specified Systems, D-M Products and HB Reynolds. It is also used as a seal on acoustical ceiling grids.

"Glass contractors will buy single-sided foam tape for storefront glazing and for hollow metal," he added. "If you go into a library and see a frame with glass and no visible material, then it has a piece of foam tape." They also have tapes for fire-rated glass that will not burn.

They carry 3M tapes that work with any building application. The 3M tapes are also used in aluminum panels. ACM (aluminum composite material) panels can be installed with the tape mounting stiffeners on the back so there is no need to drill through the panel. The result is a smooth aluminum surface. A lot of their products lend to the aesthetics of buildings.

They also carry a tape that separates the steel and aluminum on train coal cars, where the carriage is steel and the hopper is aluminum, preventing a galvanic reaction.

In some commercial buildings, there is a wool-like sheet that has open cells, like a furnace filter. They cut those to size to put inside water troughs in curtainwall systems to deter insects from building their nests.

They sell urethane and silicone sealants by Tremco and others that are used by Traco and other aluminum window manufacturers. They include products that are used to seal screw heads. Also they have products that go into masonry and control joints before caulking is applied to keep windows from cracking.

Kenny's company has made some forays into the residential housing market with a Norton tape that has a permanent film on it. The intended application is to put it on wood flooring to prevent floors from squeaking, while simultaneously sealing floor boards. It would save installers from kneeling to glue the planks. They could also apply the foam tape into the truss joints or floor joists. The result is that it masks sound and insulates and it has been calculated to cut down sound transmission by 40 percent. They tried to sell to the region's homebuilders, but it hasn't been adopted yet – the cost is the limiting factor. It would add a few thousand dollars to the cost of construction per house.

"There are hundreds of systems for fire-stopping," he explained, "and we carry caulks from Nelson and Emseal to surround a pipe penetration through a fire-rated door or ceiling. If the pipe starts to melt, the caulk swells and closes up the opening."

They have a highway product department with concrete slab caulk and sealants for the repair of roads and bridge decks. The caulking can be driven over in an hour. They sell those products to contractors or directly to PennDOT. The materials are mostly sold in "chubs" – sausage shaped thin plastic containers (like bratwurst), applied with a simple machine. "So when you're done, you can put all of the waste from an entire case in a small box instead of (ending up with) a whole skid of empty tubes, "he explained.

One interesting product is DN Hydro Active Cut that can be applied in a pipe under a sinking roadbed, and then when water is added, it swells and can raise and stabilize the roadway.

Then, there is an entire line of sanitary sewer repair and manhole repair products. Kenny explained, "Thirty percent of the water that comes into a sanitary system comes through the manhole. There are microbes at the edges that erode the concrete." He added, "There are three million sanitary sewers in our service area, and 10% of the planned sewer system repairs would be manhole repairs. You can mitigate 30% of the problem with 10% of the cost.

The 20,000 square foot warehouse is organized for product and application types. There are boxes with logs of tape, floor to ceiling.

Because (especially in winter) the products are cold, either from arriving by truck or sitting in the warehouse, he has created a simple 10' X 20' X 4' hot box, heated with compressor exhaust to prepare materials for customization.

There is a staging area near large bay doors and the entire inventory is recycled eight times a year, though some materials are rotated through more quickly. The whole system is tracked by lot number, so if there's a problem with any product, they can go back directly to the source. It controls inventory and cost as well.

"We're different," he explained. "We have a lot of products along clear lines." He's been fortunate to have a dedicated staff. "Nobody ever leaves," he quipped. "One accountant was here for 47 years and three of the sales staff have been with the company for 18, 20 and 30 years (respectively)." He added that they promote from within, so employees that start in customer service can eventually move to the sales force. "It's worked out pretty well," he added.

The staff now numbers 32 with two product managers, customer service staff, purchasing, machinists, scheduling and a sales force. They have additional offices in Columbus and Cincinnati, Ohio as well as affiliates in Philadelphia (Phoenixville), Norfolk and New York (Long Island City). BG

Company Facts

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Legal Perspective

Construction Law 2013: The Year in Review

By Antonino Legeza, Esquire

As a service to the construction industry and its clients, each year the law firm of Babst Calland provides a complimentary "year in review" breakfast seminar which provides an overview of the significant developments in the area of construction law during the prior year. For more information, or to receive an invitation to this year's seminar, which will be held on Tuesday, February 18, 2014 starting with a complimentary continental breakfast at 7:30 a.m., please contact Antonino Legeza at alegeza@babstcalland.com. The following summarizes a few notable developments that will be covered at the seminar.

The Contractor and Subcontractor Payment Act May Get New Teeth in the Future

In *Scungio Borst & Associates v. Shurs Lane Developers, LLC and Kenworth II, LLC* a contractor sued Shurs Lane Developers, LLC (the owner) and Robert DeBolt (its 50% shareholder) seeking $1.5 million in unpaid change orders that it claimed were verbally authorized by the shareholder during construction plus statutory damages under CASPA. The trial court granted the shareholder (but not the company) summary judgment prior to trial. In an unpublished opinion, the Superior Court reversed that decision on the grounds there was an issue of fact as to whether or not the shareholder was an "agent of the owner acting with their authority," which could make him personally liable to the contractor as an Owner under CASPA. In other words, although reversed on a legal technicality, the court's decision implies that the shareholder may not be protected by the corporate shield and could be personally liable under CASPA. This opinion also reminds owners and contractors alike that verbal change orders may be enforceable even if the construction contract requires them to be in writing. While not binding law in Pennsylvania, this opinion is certainly worth noting for what might lie ahead as to the application of CASPA to a construction project.

A Mechanics' Lien May Arise Even If the Improvement Isn't Actually Built

In *B.N. Excavating, Inc. v. PBC Hollow A, L.P.*, the Superior Court held that groundwork and site preparation performed by a subcontractor was an integral part of a planned construction process and gave rise to a lien even though the building was never constructed. The court observed that "nothing in the Mechanics' Lien Law requires that a structure actually exist" or that construction of the improvement must be completed. Rather, as the court explained, the Lien Law merely requires that site work must be performed incidental to the erection or construction of an improvement in order to create lien rights. This decision clarifies a 1973 decision in which the Superior Court rejected a mechanics' lien for groundwork and site preparation performed independent of (not integral to) a planned construction process.

Procedural Aspects of the Lien Law Remain Strictly Construed

In a non-precedential opinion, *Advanced Construction Services, Inc. v. Cumberland Dining Group, Inc.*, the Superior Court reaffirmed that service requirements under the Mechanics' Lien Law are strictly construed and a complaint will be stricken if the statutory service requirements are not met. The contractor in this case performed work to build out a restaurant for a tenant of strip mall, was allegedly not paid in full, and filed a lien against the interests of the mall owner and its tenant in the property. The contractor directed the sheriff to serve process on both the mall owner and the tenant at the same location (the restaurant) without considering that the defendants were separate entities with distinct ownership, management or agents. The court held that the tenant's manager was not authorized to accept service on behalf of the mall owner; therefore, service was inadequate and the lien was stricken.

This case is noteworthy because in 2012 the Superior Court ruled in Bricklayers of Western Pennsylvania Combined Funds, Inc. v. Scott's Development Co. (appeal pending) that the substantive provisions, as opposed to procedural provisions, of the Mechanics' Lien Law must be liberally construed to affect Lien Law's remedial purpose. The Advanced Construction Services decision suggests that Pennsylvania courts will continue to strictly enforce the procedural aspects of the Mechanics' Lien Law.

The Decision to Cancel an RFP is Not Subject to a "Bid" Protest

In *Scientific Games International, Inc. v Com. of Pa.*, the Supreme Court held that, among other things, that the Commonwealth was immune from suit over exercising its right to withdraw solicitations under the Procurement Code. A Commonwealth Agency, such as the Department of General Services, has the right to cancel an invitation for bids or request for proposals "at any time prior to the time a contract is executed by all parties when it is in the best interests of the Commonwealth." The Court found that the right to cancel an RFP under the Procurement Code was deliberately excluded from the procedures for filing a protest under the Code and is therefore subject to the Commonwealth's right of sovereign immunity. Although this particular case did not involve a construction contract, the holding will apply equally to an invitation for bids or request for proposals for a construction project. A contractor's right to file a bid protest where the solicitation is not cancelled entirely (i.e. a disappointed bidder scenario) remains unchanged by this decision.

Surety's "Standard Terminology" in Payment Bond Waives Safe Harbor Under the Code

In *Berks Products Corporation v. Arch Insurance Company,* the Commonwealth Court held that the express language in a payment bond waived the safe harbor protection of the Procurement Code because the bond stated it would remain in effect until the contractor and any of its subcontractors made full payment for labor and materials provided to the project. The claim in this case was made by a supplier to a subcontractor (i.e. a second tier subcontractor). The safe harbor provision of the Code bars claims against the contractor or the surety by a second tier subcontractor once payment has been made in full to the first tier subcontractor. The surety argued that it did not intend to waive its safe harbor and that the terminology of its bond is standard for all payment bonds posted for public works construction projects and essentially mirrors the language of Section 3(a)(2) of the Public Works Contractors' Bond Law of 1967, which sets the bond requirement for public works contracts. The court agreed, but stated the language used in the at-issue bond went beyond what the Bond Law requires, and the language of the bond controls its application.

A Surety is not an Insurer in Pennsylvania and Not Subject to Bad Faith Claims

In *Reginella Construction Company, Ltd. v. Travelers Casualty and Surety Company of America,* a contractor sued its surety for breach of fiduciary duty, tortious interference with a contractual relationship and bad faith. As it relates to the fiduciary duty claim, the U.S. District Court for the Western District of Pennsylvania reviewed Pennsylvania case law regarding sureties, insurers, and commercial guarantees, and concluded that (1) surety bond agreements are standard commercial contracts; (2) imposing a fiduciary duty relationship between parties to a contract is the exception rather than the rule; and (3) a surety is not an insurer. The court predicted that the Pennsylvania Supreme Court would rule that there is no fiduciary relationship between a surety and its principal and dismissed the breach of fiduciary claim. Turning to the tortious interference and bad faith claims, the court held Pennsylvania's gist of the action doctrine barred the contractor's ability to assert either claim. The gist of the action doctrine bars tort claims (1) that arise solely from a contract between the parties; (2) where the duties allegedly breached were created and grounded in the contract itself; (3) where the liability stems from a contract; or (4) where the tort claim essentially duplicates a breach of contract claim or the success of which is wholly dependent on the terms of a contract. The court found that the relationship between the contractor and its surety was purely contractual in nature, which bars the tort based claims.

Contractual Choice of Law Provision Found Not Enforecable

In *Elk River Pipeline LLC v. Equitable Gathering LLC,* the U.S. District Court for the Southern District of West Virginia determined that West Virginia law governed a dispute between two parties to a construction contract despite the fact that the contract expressly stated that all disputes arising from that contract would be governed by the law of Pennsylvania. The Master Service Agreement between the companies stated that it would be "construed, interpreted and enforced in accordance with and shall be governed by the laws of the Commonwealth of Pennsylvania, excluding its conflict of law rules." West Virginia law cited by the court states, however, that "a choice of law provision in a contract will not be given effect when the contract bears no substantial relationship with the jurisdiction whose laws the parties have chosen to govern the agreement, or when application of that law would offend the public policy of this state."

A Subjective Definition of "Occurrence" in a CGL Escapes the Kvaerner Limitation

In a recent decision, *Indalex Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA,* the Superior Court ruled that leaking windows and doors that caused physical damage such as mold and cracked walls in numerous homes gave rise to an "occurrence" under the definition set forth in the commercial general liability policy. The court found that the at-issue claims were product liability based claims, not workmanship claims, which caused damage to persons or property other than the insured's product. This distinguishes the Indalex case from the Kvaerner decision, which denied coverage under a CGL because the only property damage sustained was to the work product itself caused by faulty workmanship. The court in Indalex went on to explain that the definition of "occurrence" in the at-issue policy was different than the Kvaerner policy because it was subjective in that it applied when the alleged damages were "neither expected nor intended from the standpoint of the Insured."

Conclusion

The aforementioned cases are just some of the notable developments in the world of construction law in 2013. While some of these decisions are now the law of the land, others are not necessarily binding, but may foreshadow what is to come in the future. Despite these numerous developments, 2013 also left a couple issues we expect will be addressed in 2014. The legislature continues to ponder a significant overhaul to the Mechanics' Lien Law and the Pennsylvania Supreme Court is expected to issue its decision in Bricklayers of Western Pennsylvania Combined Funds, Inc. v. Scott's Development Co. (a Mechanics' Lien Law interpretation case).

Five Years After the Crisis, What's in Store for Fannie and Freddie?

In the fourth quarter of 2013, two events occurred that signaled a shift in the direction of the government-sponsored entities Fannie Mae and Freddie Mac. On November 7, Fannie reported earnings of $8.6 billion for the third quarter, which it transferred to the U. S. Treasury. That transfer virtually paid back the government entirely for the stake it took in the GSE – a stake the Treasury Department still maintains.

A month later, on December 10, the Senate confirmed Rep. Mel Watt (D) of North Carolina as the new head of the Federal Housing Finance Agency (FHFA). Watt is viewed as a director who will support more political usage of the GSE's and a departure from the tenure of acting director Edward DeMarco. DeMarco was a career administrator who worked to recover the GSE's losses and reform its role in the markets.

Watt is expected to be open to policy changes at Fannie and Freddie that will provide relief for distressed borrowers and more aggressively work to limit or privatize the two so that their footprint in the market will eliminate the potential for another housing crisis.

It can be argued that the seminal moment in the housing crisis took place on September 7, 2008, when the fledgling FHFA took on the role of receiver for the two GSE's that effectively backstopped the home mortgage market. Fannie Mae and Freddie Mac had been created in 1938 and 1970 respectively to provide liquidity and greater access to housing. By the summer of 2008, the cumulative weight of the bad mortgages the two GSE's had purchased from 2004 to the spring of 2008 put Fannie and Freddie under water and a selloff of their publicly-traded stocks left them illiquid.

Because the GSE's had become two of the very few financial institutions still willing to buy residential mortgages, their survival was deemed critical to preventing a complete meltdown of the housing finance system. Fannie and Freddie became the first of the government-funded bailouts over the following months, eventually costing the taxpayers $188 billion in funds.

Although the term "bailout" is used liberally to describe the situation with the GSE's, what actually took place was the purchase of new preferred stock by the Treasury Department. That working capital gave Fannie and Freddie the ability to honor their guarantees for mortgage-backed securities and their own debt obligations to foreign and domestic bond holders.

Fannie and Freddie historically acted as the standard for residential mortgages because of the massive liquidity they provided. Fannie set underwriting standards that determined what conformed to its buying requirements. Because the GSE's purchased more than half of the mortgages in the $10 trillion market, Fannie's standards became the industry's standards.

Those conforming standards had loosened as a result of political policy. The Clinton and Bush administrations used the GSE's to broaden participation in the housing market. Fannie and Freddie purchased loans with lower credit quality and reduced documentation by the mid-2000's. As the housing bubble popped and the mortgage crisis deepened from 2007 into 2008, defaults climbed. Home sales and new construction plummeted. The GSE's had much less revenue and much more bad paper to write off. Government intervention became necessary.

Like pine cones after the forest fire, however, Fannie and Freddie began to grow anew after the economy hit bottom. Along with the liquidity that came from the Treasury to buy mortgages, the government guarantee of the mortgage-backed securities provided confidence needed for buyers of MBS-backed bonds to return to the market. Demand for the housing market was hardly roaring back in 2010 and 2011, but the FHFA-directed agencies could be counted on to provide a foundation for the mortgage markets to recover.

Fannie and Freddie played a more critical role to commercial real estate as the economy pulled out of recession. As soaring vacancy rates and business failures precipitated dramatic losses in commercial real estate values, one category of commercial real estate – apartments – actually saw the fundamentals improve.

"Fannie and Freddie were the only lenders participating in that market in any considerable way. They had about 80 percent market share in multi-family," recalls Frank Guzikowski, executive vice president for Grandbridge Real Estate Capital. Guzikowski heads Grandbridge's agency business in Washington DC. "[Fannie and Freddie] carried the commercial real estate industry. Developers went to multi-family because it was the only project type they could finance and property owners went to the multi-family portion of their portfolio because it was the only thing they could re-finance."

The agencies have been a key piece in the financing of the national boom in apartments. By the end of 2013, however, the multi-family market was large enough and the financial recovery broad enough that other lenders and conduits – like CMBS or REIT's – have re-entered. Fannie and Freddie have roughly 40 percent of the credit now. Guzikowski feels that's probably the right share.

"The prudent man says that markets have kind of corrected, so things are probably where they should be," he says.

Some of the reduced role is a function of competition for deals. Edward DeMarco pushed the GSE's to demand higher fees and bigger spreads for deals to aid in the recovery of losses. When they were the only game in town, Fannie and Freddie could command those numbers but in the current market their higher costs chase deals away. The FHFA and the Obama administration have also reduced the size of the pool of funding for the agencies to lend, cutting back ten percent in 2013 and reportedly cutting another ten percent in 2014. That led to some interesting dynamics this past year.

The government's decision to cut Fannie's and Freddie's allocations came in early April 2013, well into the lending year. Both GSE's had to take measures to tap the brakes to avoid being out of the market before year's end.

In addition to the cutbacks in 2013 and 2014, the agencies have been required to price their guarantees based on the same cost of capital as the private sector. These higher spreads and costs are meant to create space for private sector competition, which appears to be the goal of the current administration. Since August of 2012, the FHFA has required the GSE's to sweep their profits entirely to Treasury, rather than paying the ten percent dividend originally set up. This also keeps the agencies from re-capitalizing and expanding into their former roles. The FHFA has also expressed concerns about how Fannie and Freddie are dealing with their non-performing loans.

The latter question was addressed by the regulator in November when the FHFA criticized the fact that neither Fannie nor Freddie was taking provisions for loans that were more than 180 days delinquent, even though 2012 accounting changes for losses have not been put into effect. Plans for implementing the rules are to hold off until January 2015. The more conservative accounting would accelerate losses and reduce quarterly profits. With the Treasury effectively paid back for its investment, along with other bondholders, FHFA seems to be ramping up pressure to use future profits

In addition to the cutbacks in 2013 and 2014, the agencies have been required to price their guarantees based on the same cost of capital as the private sector. These higher spreads and costs are meant to create space for private sector competition, which appears to be the goal of the current administration.

to write off the unrealized losses from bad loans. The GSE's have more than $50 billion in reserves for the non-performing loans but most estimates of their portfolio put the figure at $20 million or more higher.

Although the Obama administration has worked towards the goal of getting the government out of the mortgage business, the hiring of a career politician like Congressman Watt raises the possibility that the GSE's could be again used for election politics. With Democrats traditionally supporting greater access to housing, a more aggressive regulator position could encourage the use of Fannie's and Freddie's profits to expand programs of modifying mortgages, including principal forgiveness. That would engender gratitude towards the Democrats from a lot of homeowners who would suddenly find themselves with equity again, as would a more aggressive approach to lending for affordable housing.

Reforming or privatizing Fannie and Freddie also seems likely to be off the table until after the 2016 elections. The major participants in the housing industry – builders, bankers and Wall Street – find the status quo more appealing and would pressure any attempts to remove the government-backed mechanism supporting the mortgage market.

There is also the fact that after the repayment of the Treasury Department's infusion, the GSE's will contribute about $60 billion – or almost ten percent of the deficit – annually to the federal coffers.

A recent attempt to eliminate the GSE's shows how difficult any reform will be. The Corker-Warner Bill would dissolve Fannie Mae and Freddie Mac and establish a Federal Mortgage Insurance Corporation as a federal guarantor in their place. Critics of the bill point out that the new agency would offer essentially the same service to the industry without any additional safeguarding. They also attack the treatment of Fannie's and Freddie's existing investors, many of whom have already been stung by the Treasury Department's arbitrary ruling in August 2012 that profits would no longer support dividends. In the final analysis, Corker-Warner relies on private financial institutions to standardize securitization that the taxpayer would ultimately insure.

Corker-Warner aims to deal with a real problem. Private residential mortgage-backed securities –the sale of mortgages to the secondary market based on the credit-worthiness of the loans without government backing – have been missing from the market since early 2008. In 2005 and 2006, private RMBS comprised a larger share than Fannie's and Freddie's combined. The willingness of private investors to take on the risk of mortgage repayment – historically a reasonably safe income investment – is critical to a fully functioning financial system for housing. The problem is that nine out of ten mortgages today are by the GSE's or a VA/FHA loan. Corker-Warner offers a mechanism like the FDIC to back all mortgages with a reserve of 2.5 percent of the outstanding eligible mortgages. That is likely to cover the losses in a catastrophic situation like was experienced in 2008 but funding such insurance will elevate interest rates by 50 to 75 basis points above the market.

Advocates for the bill point to the fact that no institution can account for more than 15 percent of the mortgages eligible for government guarantee, although there are exceptions for those that securitize their own loans. This rule intends to allow smaller financial institutions to benefit from a federal guarantee. Corker-Warner also provides a Market Access Fund to promote affordable housing options. Despite such provisions, this replacement for the GSE's will be tailor-made for large institutions to dominate the mortgage market.

For many observers, however, a fully recovered Fannie and Freddie are more important to the U. S housing market than a reformed agency. Left to their original intentions – providing financing options for the working class to buy homes – Fannie and Freddie can function profitably again and serve the public good without becoming a burden to the taxpayer.

"That's where Fannie and Freddie should continue to be allowed to play. Wall Street has said they can do [mortgages] just as well and keep the profits but they would not have filled that role when the crisis hit and nobody was buying residential mortgages," contends Frank Guzikowski. "The middle class has relied on Fannie and Freddie. They allow lending to continue even when there are no buyers."

Master Builders' Association of Western Pennsylvania, Inc.

SAVE the DATE

The Construction Industry Evening of Excellence

is a night that celebrates the brilliant and unparalleled design and construction industry. This event unites the firms and individuals that are developing our region with a commitment of excellence in each and every construction project. This commitment to excellence will be on display during the event as the winning projects in the MBA's Building Excellence Awards program will be announced.

Thursday, February 27, 2014 • 5:00 to 9:00 P.M.

Heinz Field East Club - $25 Per Ticket

Event includes two drink tickets and strolling buffet.

For ticket information, please call the Master Builders' Association at 412.922.3912, email jobrien@mbawpa.org or visit www.mbawpa.org.

Event details to be posted first on the Evening of Excellence group on LinkedIn.
To locate the group type the following in a search on LinkedIn: Evening Of Excellence.

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See you on February 27th at the Evening of Excellence!

MBE/WBE Company Spotlight

Artistry Greenscapes Inc.

Ken Ross wastes little time in shifting credit for his company's success. "I stand on strong shoulders," he says.

Ross is the owner of Artistry Greenscapes Inc., a landscaping contractor based in Pittsburgh's Hill District. He has been working as a landscape designer and builder for nearly his entire life. The strong shoulders to which Ross refers belong to his uncle, Charles "Buddy" Shelton, who was Ross's mentor for almost 40 years.

Shelton returned to Pittsburgh in 1953 after a stint in the Air Force only to find that jobs were scarce. He worked for the City of Pittsburgh's sanitation department during a time when refuse was hauled manually to trucks by garbage men. It was back breaking work and Shelton eventually reached his tolerance limit. An entrepreneur ahead of his time, Shelton earned an associate degree in landscaping design from Penn State and founded Shelton Landscaping in 1967.

"He was always interested in trying new things and didn't quit just because something new didn't go well at first," he says. "Being in a business that's so weather-governed, you have to be able to do a lot of things."

Ken Ross mowed lawns, installed plants and managed jobsites from the time he was 12 years old. After graduating from high school, Ross went to Penn State to study horticulture and landscape design. His college years didn't provide much respite from working. Ross arranged his class schedule to have Fridays free and Buddy Shelton arranged to have work for him to do.

"My uncle would drive up every week to pick me up and bring me home, but he always sent me back on the bus," Ross laughs. "I genuinely liked the work so it was alright."

After college, Ross returned to Pittsburgh and became Shelton's right hand in his business. Ross managed the projects, overseeing the installations and helping with design. He enjoyed the hands on labor of the installation and the problem solving in the field. Designing landscapes and hardscapes was satisfying to him but he says that his uncle was not satisfied with having Ross remain just an operations asset to his company.

"He always told me I needed to come in to the office to learn the business of running the business," he says. "You've got to remember that he was a rubbish man. He had to learn the business the hard way. The work in the field, that's the easy part."

Ross also credits Shelton with teaching him lessons about growing his business that he's never forgotten.

"He was always interested in trying new things and didn't quit just because something new didn't go well at first," he says. "Being in a business that's so weather-governed, you have to be able to do a lot of things."

In 1991, Shelton decided it was time to reverse roles in the business. They incorporated Artistry Greenscapes and Ross was named president, while Shelton became vice president. Ross says the title couldn't change the pecking order that had developed over the course of 25 years of working together.

"I may have been president but you know the old saying: he was always the boss," he chuckles. "I didn't mind. That's the way I'm built anyway and I wouldn't dream of stealing his thunder."

One of the hallmarks of Ross's leadership of Artistry Greenscapes has been his willingness to adapt to the marketplace. Although the predecessor company had worked more in residential than commercial projects, Ross saw that market offering fewer opportunities and more competition in the 1990's. Since the shift in focus, Artistry's business has been roughly 70/30 commercial to residential in share, roughly the opposite of Shelton Landscaping. In 1997, the company landed a signature project, the landscaping contract for the new David L. Lawrence Convention Center.

By focusing on larger commercial projects, Artistry Greenscapes has kept the pipeline of work flowing, even through downturns. Ross says he expects the construction industry to be up-and-down and he falls back on his uncle's insistence on trying new things to help level out the cycles. He says that he describes his scope of work as "everything outside the building" but recently has begun doing indoor landscaping and lighting to meet the needs of customers and the market.

In an interesting bit of symmetry, Ross has been mentoring his own nephew, Travis Felton. Both of his own children have pursued careers outside construction, but Ross has been bringing Felton along in much the same way he learned the landscaping business. Ross says Felton has done an excellent job at the operations work in the field but now has reached the point where understanding the management of the business and running the office is his next challenge.

Ken Ross's mantra is to "stay busy," believing that pursuing work is the key to growth. "The best advertisement is your work. That's how people come to know you," he notes. "We're a small company that can do big jobs."

Company Facts

Artistry Greenscapes Inc.

Established 1991

Kenneth Ross, President

2235 Midtown Square

Pittsburgh PA 15219

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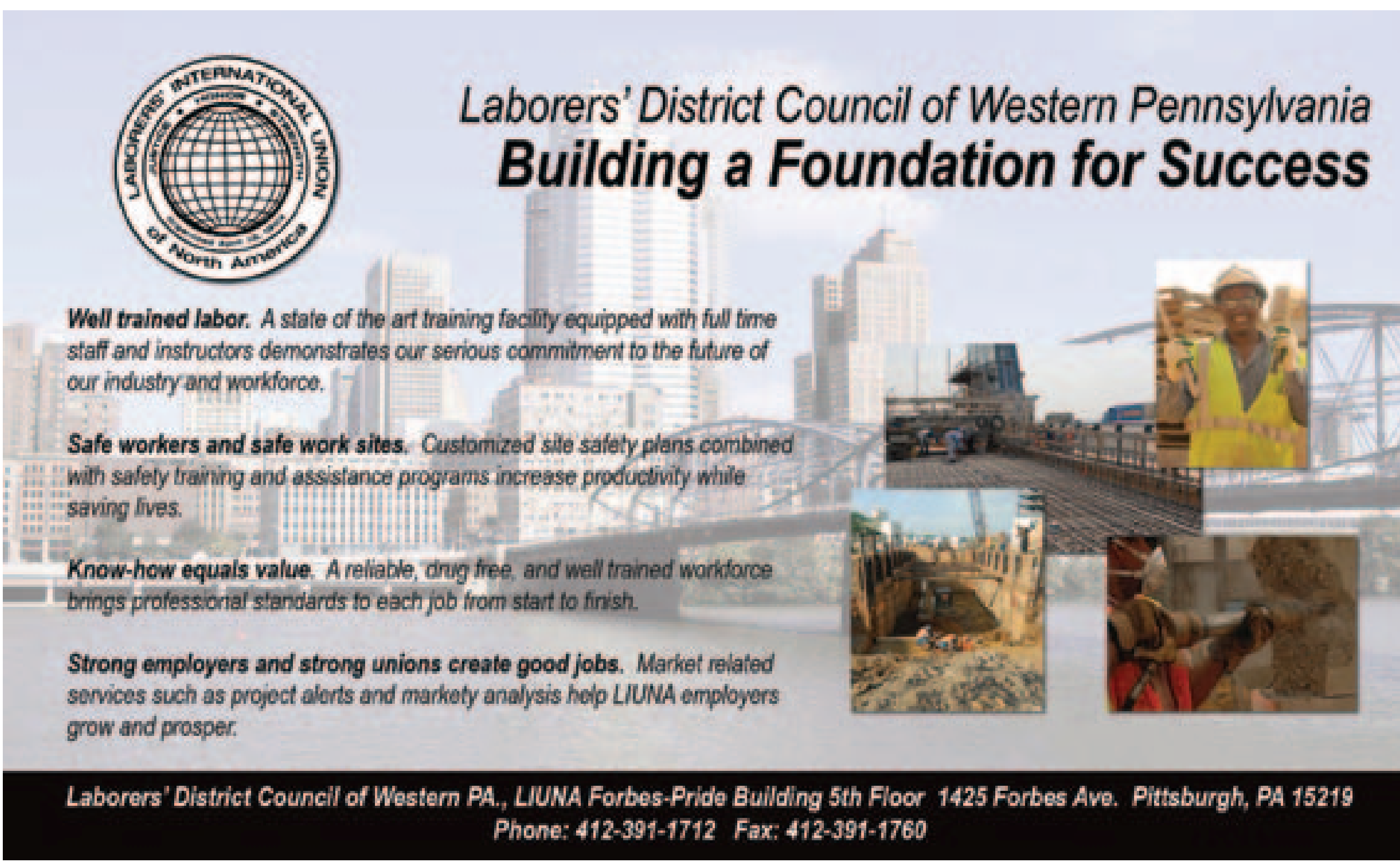
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Well trained labor. A state of the art training facility equipped with full time staff and instructors demonstrates our serious commitment to the future of our industry and workforce.
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Know-how equals value. A reliable, drug free, and well trained workforce brings professional standards to each job from start to finish.
Strong employers and strong unions create good jobs. Market related services such as project alerts and markety analysis help LIUNA employers grow and prosper.
Laborers' District Council of Western PA., LIUNA Forbes-Pride Building 5th Floor 1425 Forbes Ave. Pittsburgh, PA 15219
Phone: 412-391-1712 Fax: 412-391-1760

The Power of 32 Expands the Concept of Region

If you are just getting used to thinking of Pittsburgh as an economic region of ten or 14 counties, you may want to broaden that definition a bit further. There is a multi-regional idea called the Power of 32 that is making an impact on issues that affect a region made of 32 counties in four different states. And it's an idea that is gaining real traction.

The concept of regional cooperation across borders grows out of the idea of metropolitan interests that are driven by economic and geographic realities – the draw of jobs and transportation that come from a metropolitan center – rather than governmental borders. The Power of 32 has its roots in a multi-regional government/economic development retreat in 1999 that featured John Parr as a keynote speaker. Parr was co-founder of the Center for Regional & Neighborhood Action in Denver and was nationally known as a visionary for regional cooperation. He proposed the idea of getting representatives of government, business and non-profit sectors together to create a vision of what the future of the tri-state area might look like.

One of the non-profit organizations that was involved was the Claude Worthington Benedum Foundation. Its president, William P. Getty, was approached about leading this visioning exercise in part because two other interested non-profits were at odds with each other. Pat Getty says the concept made sense for the Benedum Foundation anyway.

"It was a natural because our territory is Pennsylvania and West Virginia," he says. "I always thought we saw the realities of the region in ways that were different from people who didn't have a reason to look at the region objectively."

The Benedum Foundation funded a study of the concept, engaging an expert from Carnegie Mellon, Don Smith (now CEO of RIDC) and his counterpart from West Virginia University, Jack Byrd. What they found quickly was little grass roots interest.

"We thought we saw complimentary regional assets in PA and West Virginia. They called up after a couple of weeks and said this is hopeless," Getty laughs. "There was so much push back. At the time, metropolitanism was the third rail of local politics."

The supporters persevered nonetheless, albeit without much progress until the middle of the following decade. With new leadership in place at the Allegheny Conference on Community Development, there was greater interest in pursuing a regional agenda in community development, or at least more tolerance for listening to ideas about cooperation between those groups. An exploratory meeting was held in August 2006, with John Parr facilitating the discussion. In attendance were some of the new regional civic leaders like Mark Nordenberg and Jim Rohr. Not all were bowled over but there was agreement to begin the work.

The Allegheny Conference, Southwest PA Commission and the newly-formed Pittsburgh Non-profit Partnership each selected 15 people from within the business, government and non-profit sectors to attend that meeting, where Parr and others spelled out how this kind of regional cooperation was being done in other parts of the country. The 45 in attendance agreed that a 'super region' might bring value to the work being done by the local groups and began a planning exercise.

Mindful that local government and civic groups rarely tolerate a 'top down' approach from what would be viewed as outsiders, the planners of the Power of 32 (which was yet unnamed) spent a year thinking about how the idea would take form and what area would make up the super region. Before a final consensus was reached about what would be included, the team decided on what the final boundaries wouldn't be.

"Probably the most important decision we made was instead of trying to use the ten counties in Southwest PA, it was decided to use the economic region of metropolitan Pittsburgh," says Getty. Their concerns were that focusing on the ten-county footprint would be redundant to the efforts of the Conference and the Southwest PA Commission, which also represent those ten counties. Bill Flanagan, one of the Allegheny Conference's executives, contacted his friends in the media in the other markets and asked them what area Pittsburgh represented to them. After assimilating that outsiders' view with the studies that were already being done, a 32-county region was identified that made up 17,380 square miles in four states.

"One of the things we hadn't anticipated but turned out to be true was when we eliminated the jurisdictional boundaries good ideas came forward. Then later you have to go back to the jurisdictional boundaries to get things done," Getty observes.

For all the thought and study that went into this well-meaning alliance, Pat Getty is quick to point out that the real momentum for cooperation came from influences beyond the control of the leaders.

"Two things changed. One is shale gas and the opportunities and challenges that it poses for the entire region. I don't think there is any question about that," he explains. "The second is the crisis in finance for local government. They don't want to merge but local government had to become more realistic about what they can do. Now there isn't the same sort of active resistance to cooperation where it makes sense. Had we started this [work] ten years earlier we would have been swimming upstream."

Three criteria were developed to evaluate opportunities or issues for the Power of 32 to tackle. First, the issue had to be a true regional opportunity. Second, the opportunity or problem had to be one where there was a plausible likelihood that a regional effort would be more effective than one by the state or local entity. Finally, some entity had to be willing to take the lead so there would be a plan to take the effort forward.

Those planning the Power of 32 decided against forming a new non-profit entity that would ultimately be engaged in doing other people's work, which would only reinforce what made people reluctant to cooperate in the first place. Instead, a Steering Committee comprised of 23 foundations and non-profits, 20 private sector companies, 11 government/elected officials, and 8 academic institutions was formed.

During the next two years the participants in the Power of 32 conducted 156 community conversations throughout the footprint of the four states, resulting in 15,000 documented comments on the needs of the areas. This led to 14 initiatives that the Power of 32 teams would begin to move forward.

As the spirit of cooperation was building Getty was looking for a poster child to galvanize the Power of 32. "If we could succeed in just one thing we could really show people how it is possible [to collaborate] to the point where it makes sense to compete regionally instead of with each other and that might be enough to get people thinking like that," Getty says. He says that the STEAM project was the first of those. "Of course, now if we don't succeed on all 14 projects I'll die a frustrated old man."

STEAM is an initiative to create a regional network to advance education in science, technology, engineering, arts and math on all levels. Getty credits Benedum's Jim Denova and Gregg Behr of the Grable Foundation as leaders and gives kudos to Carnegie Mellon for volunteering their time on the project.

"You have Carnegie Mellon applying for Federal grant money for Marshall University so that they can use CMU labs to help local public schools in Huntington, WV," he laughs. "That's regional cooperation in a way that I couldn't have even scripted. And they got the grant."

Another of the initiatives that is well underway is the P32 Site Development Fund, launched to assist development of high-quality sites in support of business relocations and expansions to the region. The fund is comprised of private investments and strategic public matching to create a pool of money to assist in site development, with emphasis on existing brownfields. P32 was created in recognition of the inadequate supply of shovel-ready industrial sites in the region and the challenges in developing such sites in uneven topography. The target is to fund up to 50 percent of loans between one and ten million dollars.

Pittsburgh Regional Alliance (PRA) is leading the P32 Site Development Fund initiative, taking the first round of proposals on October 9, 2013. The PRA hopes to approve funding on the first sites in the first quarter of 2014. More importantly, investors have responded positively to the fund, which has a goal of raising $40 million. Getty says they expect to close the fund in the first quarter, optimizing all of the $20 million strategic matching investment.

Work on the other initiatives is in differing stages of progress. After just a few years of effort – albeit 15 years after the idea was hatched – the Power of 32 has made significant strides in its most difficult challenge, which is changing people's attitudes about cooperating. Getty says that human nature and responsibility to self will always be obstacles to self identification with a 32-county region.

"People's first jobs are often to look out for their institutional well being or the interests of their institution first. Sometimes that is in conflict with collaboration," he says. "We're a long way from where we started in how people think about that. I think it's still difficult sometimes for people to cooperate in something because they aren't sure if there's a conflict with their job."

Getty cites PRA and Pittsburgh Chamber of Commerce President De Peart as an example. "De's job is to have 'wins' but some of the groups he has 'wins' against are from Ohio and West Virginia."

For his part, Peart sees the development of super regional cooperation as an outgrowth of the process of economic development. The PRA and Allegheny Conference meet and exchange ideas with their counterparts from all over the country and globe. To him, the way business has been developing around Pittsburgh has created the larger region organically.

"The movement of people for jobs and the businesses that other businesses work with – it's already there as a region," he explains. He cites examples of some of the efforts that exist. "Shalenet is cross-state. NAMII (National Additive Manufacturing Innovation Institute) is in Youngstown. The inner relationship of working together is there in a way that hasn't been there before."

Anne Barth is the executive director of TechConnect West Virginia in Charleston and a member of the steering committee for Power of 32. She shares Peart's opinion about the spirit of cooperation.

"We share much in common with Southwestern PA in terms of resources, economy and history. Working together increasingly allows us to approach problems on a regional basis," she says. "It also lets us see what groups are succeeding in Pittsburgh and other places. They serve as models for best practices and allow us to build on existing relationships of the other [Power of 32] partners."

Working together is the means to achieving any regional goal and will always be the biggest challenge for the Power of 32.

"This is an important point. It's not the Power of 32 that did these things. The Power of 32 is only an idea," Getty notes. "We succeed if people will habitually get to the point where if an issue is a regional challenge or opportunity they'll look for a regional approach rather than trying to pretend it's something different." BG

POWER OF 32 INITIATIVES

- Create a Regional Venture Fund
- Create Better Sites for Business Growth in the Region
- Create a Regional STEAM Network
- Match Education Programs to Jobs
- Promote Sustainable Use & Conservation of the Region's Water
- Implement a Regional Air Quality Improvement Strategy
- Create a Shale Initiative
- Establish a Power of 32 Caucus
- Develop a Government Best Practices Collaborative
- Connect the Regional Trail System
- Maximize Use of Alternative Fuels
- Increase Commerce Through Improved Freight Transportation
- Create a Real-Time Traveler Information System
- Maximize Success at Competing for Funding: The Capture Team

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What Do Owners Really Want From an RFP?

The time-honored method for delivering a construction project involved getting qualified firms to compete for the opportunity by submitting the lowest bid. Over the years, alternative delivery methods have arisen but most have been temporary trends rather than sea changes in the business. While it's way too early to call it a permanent change, the move towards more collaboration in delivering projects is increasing the number of projects that are procured by asking architects and contractors to respond to a request for proposal (RFP) that will be subjectively evaluated.

Perhaps because of the increase in competition for work over the past few business cycles – and the margin compression that has accompanied it – construction has become inordinately contentious. Few professionals involved in construction, regardless of which side of the table they sit, are enjoying the process. The race to the bottom has created little value and has been a prime motivator for the renewed interest in collaboration.

As described in the context of a construction project, collaboration is not about the congeniality of the parties but rather about assembling a team of professionals in a manner that facilitates better decisions in a timelier manner. In practical terms, that means putting architects, consultants, contractors and major specialty subcontractors together long before there is a documented design to bid. Because collaboration makes the most sense on projects that are complex and large, more of the better opportunities are going the way of the RFP. And that is changing behavior.

A quick distinction: with the exception of a few isolated opportunities, publicly-funded construction projects are still low bid, read-'em-and-weep jobs. What we're talking about here are private sector projects that have the discretion to deliver construction as the owner sees fit. Except for the new Children's Hospital project in the middle of the last decade, recent major projects in the private sector have been decided by a process where price was not the only factor.

For architects, engineers and contractors, the challenge then is to figure out what those other factors are and how best to communicate them to the owner. For Highmark's Alex Sciulli, that takes time spent pre-selling the job.

"My father-in-law was an engineer. He used to say that you could line up all the consultants in Pittsburgh and they would pretty much look the same," Sciulli recalls. "The person we want is the person who can walk in my shoes and understand what I need. I find that the firms that can articulate the problem, what we're trying to accomplish, are the ones that move up the ladder. The second thing is that they have a complete understanding of the scope of the project."

Sciulli explains that companies who want to work for Highmark should already be spending time with him and his staff, asking about their problems and offering solutions. What he calls pre-selling is simply building relationships with the people whose job it will be to see the construction project through, seeing what makes them tick and learning about what is behind the projects before they go out.

"If you get an RFP and it's the first time you have seen the project, chances are you're not going to get the job," he says, coming back to his two keys. "You have to know what keeps the owner up at night and have an understanding of the project."

UPMC's vice president of facilities and services John Krolicki also puts an emphasis on understanding the project. He thinks that too great an emphasis is being placed on fees and says that UPMC has a process that addresses that.

"When we put out proposals we ask for response for three different areas: fee, project team and understanding of the project," he explains. "We weight each section. People think fee is the most important but it may only be 30 percent of the job. When I look at it, team is probably the most important part, followed by the project understanding and approach."

Krolicki explains that responses to how the facility would be kept open, phasing and infection control were important to how the hospital would treat patients during the project. He says they also look to professionals to put forward ideas about how they would manage the project so that hospital operations can be optimized while construction is being done.

"If we can work with someone who can improve the schedule two weeks in an MRI replacement for example, that's a lot of revenue from using the MRI sooner," he observes. "If another contractor's fee saves us $50,000 on that same job that would be about three hours of an operating MRI's revenues."

Krolicki also sees fees and general conditions as values that can be hard to compare between contractors. He says UPMC has been going back to asking for fees that are more strictly limited to what the contractor expects to make as compensation. He's seen parts of fees end up in other aspects of the project so UPMC asks for things like uniform labor rates and tries to define general conditions more specifically to allow for an apples to apples comparison.

"The confusion comes when they want to evaluate your fees and [general conditions] without setting any parameters," agrees Steven Massaro, vice president of Massaro Corp. "That is something that should be very quantifiable depending on the length of the project. You can make your general conditions be any number you want and put everything else in a bid package."

Massaro refers to the fact that costs associated with general conditions do vary from contractor to contractor and are hardly transparent. Even the most experienced owners can't very well parse out differences in costs for temporary power or water, supervision, site storage or offices and those costs can literally be segmented out as part of other bid packages or as stand-alone bid packages. Something as obvious as the job trailer can be omitted from general conditions and put out for bid. That would make the general conditions be that much lower.

"Most savvy owners realize that the price they get doesn't really mean anything at the time of the proposal," says Anthony Martini, CEO of A. Martini & Company.

In a working hospital environment, owners also place a premium on the level of communication that takes place between contractor and architect, subcontractors and hospital staff. Like many owners, UPMC looks at the project superintendent as a key to a successful project, the person who must communicate on the front lines and will understand the consequences of a power shutdown or limiting access to an area.

Scott Pollock, Oxford Development's vice president of development, answers very succinctly when asked what he looks for in a response.

"Staffing. When we look at our most successful projects, the key is that they are staffed appropriately," he asserts. "The last thing I want is a low-ball staffing approach. It's not just staff experience but is there good QA/QC staff in place so that we pass all the inspections as the project goes along."

Don't get the impression that owners have gotten too soft about the selection process. The process is still demanding and the lists of companies receiving an RFP are often as long as the lists of bidders or proposers on open projects. For Michael Mascaro, chief communications officer at Mascaro Construction, pursuing an RFP isn't necessarily any easier than a hard bid.

"You know going into these things that you have to be competitive. That is part of considering whether or not to even pursue the RFP, depending on the resumes of the other contractors," he notes. "It's critically important to give the owner exactly what they want and nothing more or less. We do a full evaluation of that before making a deal with who we want on the team."

Mascaro isn't ready to concede that owners aren't as concerned about price as they ever were but he says that his staff looks to compete on all aspects of the job.

"RFP's are getting more complex and that is starting to chase some firms away. The WVU [baseball stadium] is a good example because of the design-build law," he explains. Mascaro Construction was part of the winning team that pursued the university's new ballpark, which is being delivered design-build. West Virginia has a fairly complicated procurement law regarding design-build and Mascaro feels that the law was a major reason there were only four responses.

Bernie Kobosky is director of business development for PJ Dick. He believes that price isn't as important in a value-based selection process.

"We were just having this conversation internally. When we look at projects we didn't get, more of our stumbles were where we just got beat in the interviews," he admits. "Maybe we sent the wrong people or missed the keys to the project or misjudged the room. I don't think price is the main issue at the time of the RFP."

Anthony Martini agrees. He looks at his competition as being pretty even on fee most of the time. "Maybe it's plus or minus half percent. Unless an owner makes price a big issue I think it comes down to who they like the best, who the owner thinks they can have the best working relationship with," says Martini.

"The emphasis is changing. It's more about the dynamics of interpersonal relationships and you can see that with the questions that are being asked at the interviews," says Kobosky.

The interview questions aren't the only thing changing. With competition intensifying over the past few years, owners have taken advantage of the increased interest by ratcheting up the criteria for qualification, sometimes to an extreme.

"RFP's are getting so specific. We have seen it increase to the point where Mascaro couldn't even qualify for projects we've done before," says Mike Mascaro. "Some of these are looking for project managers with at least ten years experience on some specific number and type of projects that just don't get built all that often."

To illustrate Mascaro's point, asking for a team that includes experience building cancer research facilities would limit responses to a handful of Western PA firms. Asking that the teams include individuals who had worked on five cancer research centers of at least $50 million in cost would virtually eliminate every firm in Western PA.

Corporate values are also working their way into RFP's more frequently. With the expansion of the oil and gas business into the region, firms are discovering that they are dealing with publicly-traded global companies that value safety to a high degree. Firms that haven't dealt with this are finding that their own corporate cultures – right down to letterheads – must reflect a pervasive safety environment, even when their safety track records are impeccable. Diversity and sustainability are two other values that are showing up more and more.

"Highmark is serious about diversity. When we look at our subscriber base, 25 to 30 percent are of diverse background," notes Sciulli. "We're trying to find professionals that reflect the same concern about diversity. If they have a principle or sub-consultant who is a minority or woman, it can be influential in our decision."

Two local associations are working together to develop a best practices manual to guide owners through value-based decisions in the more collaborative environment that is emerging. The AIA-MBA Joint Committee has been holding meetings with owners from Western PA to talk about the issues that arise when putting together a team during the early stages of a project. It's clear that owners are more interested in creating a good fit because it's good for their business in a larger context than in past.

"Over the last four to five projects we've awarded from an RFP only one had the lowest fee," says Krolicki. "Fees are so close that it's not worth choosing the wrong team. In a hospital, working around patient care, it's so critical that we have a team that understands how to work in that environment."

"We have to look at who's on the team," says Sciulli. "I'm not going to be working with the sales person for the architect or contractor. I'm working with the project management team. If there's a comfort level there, that's paramount." BG

INDUSTRY & COMMUNITY NEWS

dck Raises Money & Awareness

On October 10, dck worldwide had a team of 50+ employees and family members participate in an inspirational and memorable evening—a non-competitive walk that began at Heinz Field and ran along the North Shore. The 15th Annual Western Pennsylvania Light the Night Walk benefits The Leukemia & Lymphoma Society and honors those that lost their fight with blood cancers. Through employee and company contributions, dck made a donation of $10,000, which will help fund therapies and treatment advances for blood cancer patients.

Employees of dck worldwide made a donation of $10,000 for the several employees of dck and their families who were directly impacted by the horrific Typhoon Haiyan that hit The Philippines on November 8, 2013. Money was raised through company-wide raffles and contributions. dck worldwide's San Juan Mall project team contributed money and purchased turkeys and other groceries for local community members to help make their Thanksgiving Day special.

Employees and family members of dck worldwide's Pittsburgh office worked with the Pittsburgh Post of SAME (Society of Military Engineers) on November 8 at the National Cemetery of the Alleghenies in Cecil Township. The group of volunteers helped to maintain and clean the individual grave sites of our fallen veterans to honor our heroes on Veteran's Day weekend.

dck worldwide employees and families at the Light the Night Walk.

Young Constructors & Pens Help Kids

The MBA's Young Constructors joined with the Pittsburgh Penguins to raise over $4,000 and donate 200 toys to the Marines Toys for Tots program at its seventh annual holiday party, held at the Hard Rock Café on December 11.

Joining representatives of the Marines and the Penguin's Ice Crew are past YC committee chairs (back row from left) Jim Frantz of TEDCO, Jendoco's Michael Kuhn, Nello's Gino Torriero, current YC Chair Jen Landau and past chair Brett Pitcairn from PJ Dick.

(From left) HDH Group's Mark Hondru with PJ Dick's Mike Koza and Brian Budny at the Hard Rock.

Emily Timko and Cindy Bittel from RCx Building Diagnostics with Mike Sell from Avant.

(From left) Nick Rosky from Volpatt Construction with Front Studio's Lexi Chung, Greg Komar from AIM Construction and Volpatt's Geoff Scott.

Bruce Bartholomew and Brian Alston of Phoenix Roofing with Jendoco's Scott Koontz at the YC holiday event.

Sharon Landau with Babst Calland's David White at the YC holiday party.

Nello's Gino Torriero (left) and Jendoco's Domenic Dozzi with the Penguin's Ice Crew.

Lisa Wampler from Cohen Seglias with the PBX's Jaci Yunker.

Shay from the Pen's Ice Crew with Mark Dietrick of Case Technologies and Rob Sklarsky from RJS Construction (right).

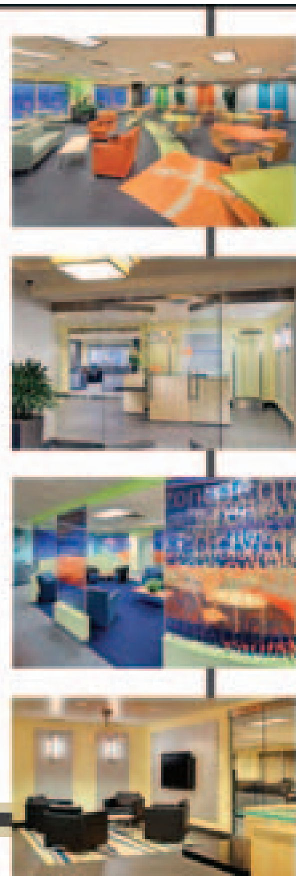
(From left) Rob Douglass and Charles Jenkins from Douglass Pile with NILCO's Dan Fryz at the PBX annual banquet.

Enjoying the PBX Banquet are (from left) IWEA's Bill Ligetti, Regis Claus from the MCA, the MBA's Jack Ramage and McCrossin president Bob Leahey.

Pentrust's Jim Noland, Jason Fincke from the Builders' Guild and Bill Waterkotte, executive secretary of the Carpenters Regional Council at the Carpenters' holiday open house.

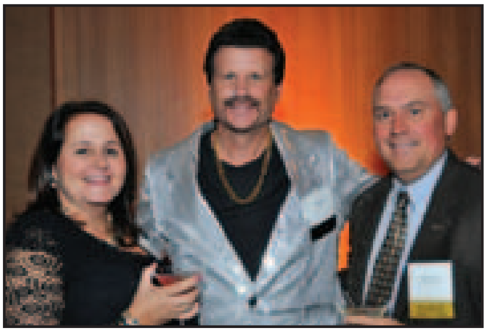
Mark Edgar from Mosites with wife Denise and Dave Balmert from J. J. Morris & Sons (right).

Jendoco's Michael Kuhn (left) with David Salicce from Verizon and LLI's Jamie White at the Cystic Fybrosis Passion for Wine fundraiser.



Mascaro Tends Bar for Cystic Fibrosis

On November 21, Mascaro held its fifth annual Guest Bartender event to raise funds to fight Cystic Fibrosis. Mascaro's Nate Martin – whose daughter Sophia is battling Cystic Fibrosis – and CEO John Mascaro Jr. were the guest bartenders at McFadden's on the North Shore. The event raised over $5,000.



PBX executive director Del Walker (center) gets into the 1970's spirit at the PBX's Annual Banquet at the Rivers Casino with Andy Vater and wife Gail.

Joe Burchick (left) with Elmhurst's Bill Hunt and Sen. Jay Costa at the groundbreaking for Elmhurst's Schenley Place in Oakland.

John West from Mascaro (left) with Rep. Tim Murphy at the dedication of the World War II Memorial on the North Shore.

Awards & Contracts

Landau Building Company has been awarded several projects at Heritage Valley Beaver. One is the relocation of the existing Bereavement Room into the E.R. waiting room to make way for a new CT scanner for the Emergency Department. A new management office will also be created next to the new Bereavement Room. The other is a multi-phased project, part of HVHS's larger plan to renovate the entire Radiology Department. Work includes temporary Ultrasounds, New Interventional Suite for new Siemens equipment, expanded work staff areas, new locker and dressing rooms, temporary patient holdings and a new EKG/Echo/Stress Suite.

Landau Building Company has begun renovations for Mitsubishi Electric Power Products Inc. at Buildings 510 and 520. Work includes minor interior renovations for the relocation of departments and addition of cranes (done direct by MEPPI). Upgrades are also being performed to the Training Room, Test Lab, Shipping & Receiving, Employee Break and Locker Room. New areas include a Customer Break Room and Restrooms.

Massaro Corporation is the construction manager for the new $2 million Bayer Welcome Center and Farmstead at the Pittsburgh Botanic Garden in North Fayette Township. Indovina & Associates is the architect for the project.

Point Park University has selected Massaro Corporation to serve as the general contractor for a two phase renovation project within Lawrence and West Penn Halls. This 3,000 square foot project includes renovation to two classrooms and the creation of office space to accommodate the needs of the faculty and staff. Stantec is the designer on the project.

Massaro Corporation is serving as the design builder for the conversion of the former East Liberty YMCA into an Ace Hotel. Ace Hotel is a boutique hotel with only seven other locations around the world and the East Liberty location will include 63 guest rooms, a restaurant, ballroom and gym. Interior demolition and removing asbestos have already begun. Moss Architects is the designer on the project.

Northwestern Mutual Life has selected Massaro Corporation to serve as its builder for its renovation needs at its corporate office in downtown Pittsburgh. The Design Alliance is the architect on the project.

A. Martini & Co. was selected to provide preconstruction and construction services for the interior renovation of St. Clair Country Club. The scope includes the renovation of the men's grill, the ballroom and both the casual and formal dining rooms. The project will start in January 2014 and be substantially complete in April 2014. The architect is Chambers Design of Baltimore.

A. Martini & Co. was selected to be the general contractor for "You Grow Café" - the fit out of a state of the art teaching kitchen and café for Google Pittsburgh. This $3,000,000 contract includes preconstruction services. Completion is set for June. Strada Architectural LLC is the design firm.

A. Martini & Co. was the successful bidder on the UPMC Presbyterian Hospital Peripheral Vascular Lab. Work started December 16 with a completion date of January 31, 2014. The architect is Radelet McCarthy Poletta Inc.

Sewickley Academy selected Mosites Construction to renovate and modernize its Oliver Building classrooms. Glance & Associates is the architect for the $3.3 million project.

Mosites Construction was the successful contractor on the first section and bridge structures of the Southern Beltway. The $14.4 million project is part of the Turnpike Commission's plan to complete I-576 from the Findlay Connector at Route 22 to I-79 near Southpointe.

Uhl Construction was the successful contractor at the University of Pittsburgh's renovation to the lobby and waiting area of the Salk Hall Annex at the main campus in Oakland.

PennDOT awarded a contract to Joseph B. Fay Company for the first phase of the Route 219 South Extension. The $110.5 million package is the first piece of an 11 mile expansion of the limited access highway between Somerset and Meyersdale.

F. J. Busse Company was the successful contractor on the Porter Hall renovations at Carnegie Mellon University.

Mascaro received a contract from Highmark to renovate the 10th Floor at its East Commons Professional Building at Allegheny Center Mall. The project is expected to be completed in the spring of 2014.

Mascaro received notice from the Pennsylvania Department of General Services that its team was selected as the design-build contractor for the elevator modernization project at the University of Pittsburgh's Cathedral of Learning. Other members of the Mascaro team include: Otis Elevator, Indovina Associate Architects, and Loftus Engineers.

Mascaro's design-build team provided the best value technical and cost proposal to West Virginia University for its new baseball stadium. Members of the Mascaro design-build team include DLA Architecture & Interior Design, LLC; Populous; Langan Engineering & Environmental Services, Inc.; M-E Engineering, Inc.; Allegheny Design Services; The Sextant Group; and KMA Design.

Pittsburgh Business Times recognized Mascaro as a Best Places to Work in Pittsburgh and the Pittsburgh Post-Gazette recognized Mascaro in its Top Places to Work survey.

Jendoco Construction Corporation was selected by Pittsburgh Musical Theater for the reconstruction of its roof. In addition to the replacement of a Styrene-Butadiene-Styrene (SBS) inverted roof membrane, an approximate 700 square foot area of the lower roof is to be installed with an extensive green roof system, based on a LiveRoof brand green roof design. The project includes repairs to masonry and replacement of lintels at windows, demolition, abatement, and compacted fill of two on-site structures. Rothschild Doyno Collaborative is the architect.

Flexsys America, L.P. awarded Jendoco Construction a contract for construction of a 120 foot blast wall and additional exterior improvements at its Monongahela PA facilities.

PJ Dick was the successful bidder on West Virginia University's $77 million New Agricultural Sciences Building. The 201,000 square foot building will hold lecture halls and laboratories as well as administrative space.

PJ Dick was awarded construction management at risk services for Central Catholic High School's new Science, Technology, Engineering and Math building.

PJ Dick, along with ATI, Inc. will provide design-build services for Phase II of the Dorsey Run Correctional Facility in Jessup, MD. This project includes the construction of two housing unit buildings, a Support Services Building, a Search Building and outdoor recreation as well as a perimeter fence system and access roads.

Horizon Properties Group selected Rycon Construction to act as construction manager on another new large office building at Southpointe. The 207,000 sq. ft. six-story will cost nearly $20 million and the project is expected to be complete by the end of 2014.

CBL & Associates Properties selected Rycon Construction to renovate an existing Boscov's store into a new location for Dick's Sporting Goods at Monroeville Mall. The $5 million, 54,000 sq. ft. project is scheduled to begin in early 2014 with construction duration of five months.

Rycon is responsible for the interior fit-out of a new Dick's Sporting Goods store over 600 miles from Pittsburgh in Seabrook, New Hampshire. The 35,000 sq. ft. project will cost approximately $3 million and was designed by Herschman Architects.

Rycon's Special Projects Group is currently responsible for four renovations at multiple Duquesne Light facilities throughout the region. The work consists of demolition, restroom renovations, pad preparation, garage door repair and an elevator addition. All of the projects are scheduled for completion by February and were designed by Michael Baker, Jr.

dck worldwide, through its dck/Bird joint venture, is serving as general contractor for the $405 million Mall of San Juan in Puerto Rico for high-end mall developer, Taubman Centers. The two-level, 640,000 square foot enclosed mall features a Nordstrom and Saks Fifth Avenue along with 100 more specialty stores and restaurants.

dck worldwide is providing preconstruction services for the new Montauge Hotel to be built on the site of the formerly planned Spanish Peaks Lodge near the Big Sky ski resort in Montana.

Faces & New Places

Rycon Construction, Inc. added Michael Lawson as a senior estimator in the Building Group. He served in the United States Marine Corps and received a master's degree in civil engineering from the University of California Berkeley and brings over 16 years of construction industry experience to the Rycon team.

Al Grasso joined Mascaro as director of market & client strategy. Al has relocated back to his hometown of Pittsburgh from Arvada, Colorado, where he was director of marketing and strategy for Adolfson & Peterson Construction.

Rachel Yarros became a full-time member of the Mascaro family as an assistant project accountant. She had been an intern with Mascaro since 2011 and graduated from the University of Pittsburgh with a bachelor's degree in psychology in 2013.

Chaz Ott joined PJ Dick Inc. as a mechanical estimator in the main office. Chaz brings eight years of experience to the PJ Dick team.

Dingess, Foster, Luciana, Davidson & Chleboski, LLP, a Pittsburgh-based firm specializing in construction and engineering law, is pleased to announce that Samantha Brutout has joined the firm as an associate attorney. Prior to joining DFL Legal, Samantha was an associate in the litigation and e-Discovery practice groups of K&L Gates. Samantha earned her J.D. from the Case Western Reserve University School of Law.

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Closing Out

What Transportation Means for Economic Development

David J. Malone

Chair, Pittsburgh Regional Alliance

Dave Malone

Thanks to the direction of Governor Corbett, PennDOT Secretary Barry Schoch and members of the PA General Assembly, with specific acclamation to Representatives Dan Frankel and Sam Smith for their outstanding leadership, Pennsylvania's most comprehensive piece of state transportation legislation in decades was signed into law last November. This historic bipartisan funding package, which was championed by a broad coalition of statewide business and labor organizations, will provide about $2.4 billion in additional investment into our state's transportation network by the fifth year of the plan. The Governor estimates that the bill will result in 50,000 new jobs and 12,000 jobs retained.

From an economic development standpoint, the importance of this legislation cannot be overstated and represents a big win for our region's future. At the Pittsburgh Regional Alliance (PRA), we work directly with businesses across the region and around the world to encourage them to expand or relocate here. When businesses are conducting their due diligence, transportation infrastructure is often an important factor in their evaluation process.

In recent years, our economy has outperformed that of the nation as a whole. And interest in our region by business decision-makers has never been higher. Yet, despite this heightened interest, our region has room to improve on the transportation infrastructure front due to years of underinvestment.

One recent example illustrates the critical importance of transportation investment to economic development and job creation – and the consequences of underinvestment. A Pittsburgh-area manufacturing company was searching for a location to construct a new facility for building high-tech equipment for the energy industry. The company found a reclaimed brownfield site in the region, but it was accessible by an aging narrow bridge that would have to be replaced. Since neither PennDOT nor the county had plans – or the money – to construct a modern bridge, that factory, with its millions of dollars in capital investment and nearly 300 jobs, was built in a state hundreds of miles away.

As transportation maintenance and improvement projects get underway, stories like this will soon be something of the past. And our state will remain competitive and attractive as a place to do business.

In addition to increased funding for roads, bridges and highways, the transportation package provides a dedicated revenue stream for transit systems across the state. This is important because nearly half of all employees in downtown Pittsburgh rely on transit. Without the dedicated revenue provided in the plan, the Port Authority may have faced additional cuts to service that would threaten peoples' ability to get to work, placing our region at a huge competitive disadvantage. The Port Authority now projects that no further service cuts will need to take place for the foreseeable future.

As part of a multi-modal fund, the plan also includes increased dedicated investment for passenger and freight rail, ports, bicycle/pedestrian and aviation projects. Airports throughout our region, including Pittsburgh International Airport, are critical to economic development in terms of air service and cargo. This multi-modal fund will help improve our aviation facilities to make our region more competitive.

While this all represents enormously good news for our region's economic future, let's not forget that even today, southwestern Pennsylvania's major transportation assets are helping to drive economic development deals. Two recent examples illustrate this reality.

Last September, CSX announced plans to invest $50 million to build a major intermodal terminal in Stowe Township and McKees Rocks, which will create 360 construction and 80 permanent jobs. This significant investment, which the PRA has been engaged with moving forward since 2008, will advance our region's importance as a transportation hub by expediting the shipment and delivery of goods and materials and by further opening our region to global markets.

Then there's Gordon Food Service. The company recently broke ground on a major new distribution center in Findlay Township, one of the largest such investments in our region. The $80 million investment will create 300 jobs. Why did North America's largest family-owned and managed broadline foodservice distributor decide to locate in Findlay Township? In part, it's because the Findlay Industrial Park is located near I-376, which provides easy access to deliver goods to customers across a multistate footprint.

These two projects represent major economic development wins for our region. They demonstrate the vital importance that a well functioning transportation network has in encouraging businesses to relocate or expand here. It's encouraging that lawmakers across our region and state recognized this, and worked together to bring our transportation system into the 21st century.

As a result, we can now hope to see many more success stories like CSX and Gordon Food Services.

Dave Malone is the CEO of Gateway Financial, a national independent insurance advisory firm located in Gateway Center, Downtown. He can be reached at 412-497-1750.