BreakingGround

THE MAGAZINE OF THE MASTER BUILDERS' ASSOCIATION OF WESTERN PENNSYLVANIA

JULY/AUGUST 2012

OFFICE & INDUSTRIAL UPDATE

THE PERFECT STORM
FOR OFFICE & INDUSTRIAL DEVELOPMENT

MID-YEAR ESTIMATES
FOR HOUSING & NEW CONSTRUCTION

A BULL MARKET
FOR BUILDING OWNERS

CONTENTS 2012

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Publisher's Note

The Gemini sign of the Zodiac is the sign of the twins and those born under that sign are often described as having dual natures. I have absolutely no belief in any of that nonsense but on one of the last days of the research for this edition of *BreakingGround* I was struck by the duality of the predicament the construction industry finds itself and decided to check when the Gemini period's dates occurred. If you are not already aware, the sun transits this area of the Zodiac between May 22 and June 21, which was the date I decided to check.

The reason I decided to check was that virtually everything that I looked at and everyone that I talked to seemed to have two conflicting sides. There seems to be no clear signal about where our economy or the real estate market or the construction industry is going at the moment.

Unlike 2009, when there was no reason for optimism to be found, there are abundant reasons to view the current day with optimism. If you are looking to find support for a 'glass half full' kind of outlook, you can find evidence in stock markets, architectural backlogs, housing prices and plenty of other places. In most of those same places you can also find evidence that things are not going in the right direction. To cut through the conflict, focus on the hard fundamental data. That kind of drowns out the narrative of those who deliver the data, like the business media or economists.

When you do that you strip away what you think people might do and focus instead on what has historically happened when these conditions existed before. Business cycles are fairly logical things. For example, if people change their habits and eat more meals out, before long there is a restaurant boom. Restaurateurs discover this and begin building restaurants until the late comers over build and voila, you have a restaurant construction bust. The recession side of the cycle usually lasts until the lack of construction creates another shortage and another cycle begins. This has worked in America because we continue to have more people living here. So the million dollar question seems to be why isn't it working now?

One short answer could be that we haven't had a long enough bust to create a shortage. There's validity to that. It's certain that the depressed new construction of housing could fall into this category, since the excess inventory was exceptionally excessive. For four years builders have started less than half the number of homes needed to keep pace with household formation. Yes, there was overhang but the demographics should have consumed that in 2010 or 2011 in the worst case. So why isn't there growth in new home construction all over the land? I think fear has as much to do with it as foreclosures.

Building a house is an act of faith. The same is true of buying one or developing a warehouse or expanding a plant or a CEO committing to a new headquarters three years out. And faith is a little short in supply right now when it comes to our economy.

Don't misunderstand me. I don't mean 'build it and they will come' kind of faith. That's not the best rationale in any endeavor but it certainly doesn't wash in construction or real estate. What we're suffering from now is a lack of faith in the evidence of our eyes and minds. Businesses are running out of space and are sitting on lots of cash but that evidence is no match for the concern that whatever is going well now could end in a moment, with little warning. And for the record there is plenty of warning.

What business owners and executives experienced in the summer and fall of 2008 has had a defining impact on their current, and perhaps future, decision-making. The crash of September and October of 2008 was our 'economic Pearl Harbor' – as Warren Buffet put it. The difference is that Americans didn't watch Pearl Harbor in real time, on their desktops. The business owners who survived the last recession are likely to be scarred by it in the way that our grandparents were scarred by the Depression.

My grandmother washed her aluminum foil so she could reuse it. That amused the heck out of me as a kid but I'm guessing she took comfort in the fact that she wasn't going to spend any money the next time she needed aluminum foil. How do you think a developer who built a spec office in 2008 feels today?

The good news is that I have one solution to the problem. Turn off CNN, Fox News, CNBC, and the like. Delete MarketWatch and WSJ.com from your favorites. Or at least, bear in mind how these organizations make their money. Business news is among the most boring of content – except for this magazine of course. How it got to be a 24/7 topic is beyond me but there isn't enough news to fill a full schedule unless the media creates it. And by the way, any story that begins with 'Could the next big crisis be…' or 'Europe may be…' isn't really a news report. It's an opinion meant to appeal to your emotions.

We ignored a big problem five years ago and it bit us in the backside. Let's not waste time and energy looking for the next big thing to bite us. It creates fear and indecision and overlooks the reality that the next big thing won't sneak up on us any more than the mortgage crisis did. This is construction and real estate. There will be a next big problem at some point. But the difference between not ignoring it and searching it out is the difference between sitting on the sidelines and getting back into the game. It has been four years of wait and see. It's time to play the game again.

Jeff Burd

For nearly 10 years, Highmark Blue Cross Blue Shield has been a proud supplier of health insurance for Team USA.

REGIONAL UPDATE

At mid-year, two somewhat surprising story lines explain how 2012 is unfolding and is likely to finish. One thread is disappointing; the other points to more exciting prospects for the middle years of the decade.

The more upbeat trend in the market is the positive outlook for housing. Benchmarks from the national housing market have been improving all year but the market in metropolitan Pittsburgh – and the entire Southwestern PA region for that matter – has moved from recovery to robust. Reports from the top executives at the region's four largest real estate firms – Howard Hanna Real Estate, Prudential Preferred Realty, Coldwell Banker and Northwood Realty Services – all point to brisk sales and more surprisingly, multiple offers on a growing number of properties. Demand for houses is up but all the realtors point to the same problem thus far in 2012: a lack of listings.

Ron Croushore is president of Prudential Preferred Realty and also serves as president of West Penn Multi List. His take on the state of the business is positive from both perspectives.

"Our market's going really well right now," he says. "I see the numbers from the 13 counties [in West Penn Multi List's territory] and sales are moving at a brisk pace all over. Our sales are up 30 percent year-over-year but that could be higher if we had more inventory."

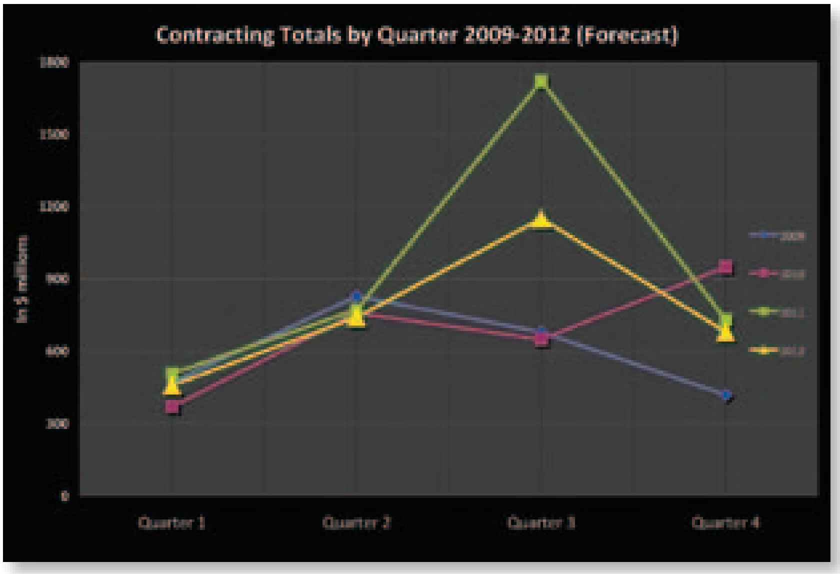
"There is a shortage of new construction, very little inventory of starts and new construction is kind of an impulse buy," says Howard "Hoddy" Hanna III, CEO of the region's largest realtor. "We should have five to six thousand starts based on history and have had only three thousand or less over the past few years. That's what is missing from the market."

Hanna's observation is borne out in the data for the first six months. Sales of new homes are escalating, with April's numbers up 11 percent over 2011 and May up almost 20 percent. Prices are also on an accelerating path, with year-over-year increases above ten percent in most areas. Such dynamics, when combined with a declining inventory (May's new listings were down 2.5 percent) should produce fertile conditions for new construction; but in fact, there is little improvement on that front. Actual permits for the first five months, plus an estimate for June from the *Pittsburgh Homebuilding Report* show 907 new single-family detached units and 598 attached or apartment units started. While that's a robust 21.6 percent increase over the first six months of 2011, the 1,505 total units is only about half what the market should be producing.

Limited financing has been one key drag on new construction. For a few years the tighter lending conditions affected both potential buyers and builders but that has eased significantly for the homeowner by 2012. For developers of new homes, however, the market is still tight. In part, the problem is that lenders are still carrying an unusually high number of lots on their books from the years of the recession. As you might imagine, this makes banks reluctant to fund new development and even reluctant to finance the spec homes that custom builders really need to move new construction. And even for banks that are willing and interested in lending to new development the regulators have pressured appraisers to be more conservative, regardless of market conditions. In southwestern PA, for example, where inventory is short, appraisers are required to discount the take down rate for new development. Extending the estimate of how fast lots will be sold can push a project from feasible to unappealing, even though demand for lots may be high.

On balance of course, there are worse problems to have than a shortage of lots being developed, particularly when there is inventory that could support more robust growth in three of the more desirable communities – Cranberry, Adams and Pine Townships. The structural problem is nonetheless one that could stunt growth at a critical time for homebuilders. News of the improved conditions may be bringing some developers off the sidelines but the lag time for new residential development is somewhere between twelve and eighteen months, meaning that the next twelve months will be especially important to the near-term future of regional residential construction market.

The non-residential sector of the market has been unfortunately, as disappointing as the housing market has been encouraging. Solid contracting volume in the first



A slowdown in activity since spring is indicating that the 2011 contracting volume will be an anomaly rather than the start of a new trend.

Region	2008	2012	Change
Pittsburgh	1,006.2	1,020.9	1.46%
Boston	2,167.8	2,130.7	-1.71%
Indianapolis	781.4	760.4	-2.69%
Denver	1,070.9	1,041.3	-2.76%
Minneapolis	1,525.3	1,482.7	-2.79%
Baltimore	1,084.9	1,052.2	-3.01%
Philadelphia	2,445.4	2,359.3	-3.52%
Cincinnati	901.6	868.2	-3.70%
Kansas City	858.5	826.4	-3.74%
Richmond	518.6	499.1	-3.76%
Benchmark Avg.	1,187.2	1,142.3	-3.78%
St. Louis	1,175.6	1,120.1	-4.72%
Charlotte	753.2	712.7	-5.38%
Milwaukee	752.4	711.0	-5.50%
Detroit	1,679.9	1,581.0	-5.89%
Cleveland	904.8	846.7	-6.42%

Pittsburgh is the only city among 15 comparable metropolitan areas that has more employment now than in 2008.

quarter seemed to have set 2012 in the right direction, although bidding early in the year was sporadic. Since mid-April however, bidding and new opportunities in general have declined.

Contracting for the first six months was roughly the same as the volume in the first half of 2011, with an estimated $1.2 billion booked compared to the $1.28 billion last year. Those results mask the trend in the market, which is almost a perfect mirror image to the way 2011 unfolded. Contracting for January through March of 2012 topped $460 million meaning the second quarter increased by less than $300 million. In 2011 the volumes for the first and second quarters were roughly the same as this year but the summer brought the start of construction of several large projects, including the $1.2 billion Allegheny Ludlum plant. Of greater concern than any comparison to 2011, which ended up with a volume that was triple the mid-year activity, is the fact that the trend for 2012 is more in line with the activity in the years of 2009 and 2010. Those years, while technically after the end of the national recession, were years of declining activity.

CONTRACTING FOR THE FIRST SIX MONTHS WAS ROUGHLY THE SAME AS THE VOLUME IN THE FIRST HALF OF 2011, WITH AN ESTIMATED $1.2 BILLION BOOKED COMPARED TO THE $1.28 BILLION LAST YEAR. THOSE RESULTS MASK THE TREND IN THE MARKET, WHICH IS ALMOST A PERFECT MIRROR IMAGE TO THE WAY 2011 UNFOLDED.

There will be a bit of a spike in the third quarter due to the start of the $380 million Tower at PNC but the fourth quarter is unlikely to alter the trend for 2012.

First quarter volume is historically between 15 and 20 percent of the full year's activity, while the second quarter share is roughly double that, often exceeding 40 percent of the full year's volume. Construction does not unfold quite as predictably as say, retail sales and it is foolish to draw a conclusion in July about the contracting climate to come; however, a second quarter that trends towards an annual volume that is less than $2 billion is not going to encourage those expecting 2012 to be the first stage of a new growth cycle.

In many ways the slowdown flies in the face of the economic health of the region. The Commerce Department analysis of the employment landscape in the metropolitan areas since the recession looks at cities of similar size and character to compare job growth or decline. Not only does Pittsburgh's 1.46 percent growth hold up favorably against the benchmark average of a 3.78 percent decline, but the region is the only one of the fifteen in its cohort – including Boston, Philadelphia, Minneapolis, Richmond and Charlotte – that has more jobs now than in 2008. Growth in jobs creates the demand for more commercial space and the data on occupancy after the first quarter bears that out.

CONSTRUCTION HAS BEGUN ON SEVERAL OF THE OFFICE PROJECTS THAT HAVE BEEN IN THE HEADLINES FOR THE PAST HALF YEAR.

According to Newmark Knight Grubb Frank, the region's office vacancy rate is under 16 percent for all classes, with net absorption of 166,000 square feet through the first quarter. Grubb's analysis showed vacancy for Class A office in the central business district at only 6.9 percent, and vacancy in the north (8 percent) and Oakland (6.6 percent) equally stingy. Only the east suburban vacancy rate of 25.3 percent lagged the regional average. In its research reports on the first quarter, Jones Lang LaSalle reported slightly higher vacancy rates in the CBD at 10.8 percent for all classes but lower suburban vacancy at 12.1 percent. Both organizations saw rents creeping higher, averaging roughly $20 per square foot.

Retail occupancy jumped significantly in the first quarter compared to the same period in 2011. Vacancy rates for all retail space in metropolitan Pittsburgh were at five percent, according to Grant Street Associates first quarter Market Snapshot, with rents increasing between five and seven percent. Construction is underway on the new Dick's stores in Cranberry Crossroads and South Hills Village, as well as the Target store there. Rumors of additional WalMart stores have circulated but bids have not been taken yet on the WalMart's previously announced in Moon and Ross Townships, so any other new stores will be on tap for 2013 or later. The outlook for the remainder of the year is for construction limited to specialty and infill shops, meaning that the fundamentals should remain intact going into 2013.

Industrial space is equally limited. According to the first quarter reports of Colliers International the overall industrial vacancy rate was 7.8 percent with virtually all of the 115,000 square feet delivered into the market being absorbed. The quoted rents for industrial space rose seven percent over the end of 2011.

Almost nothing about the slowdown is rooted in the fundamental supply and demand relationship for space. In fact, if the anecdotes from real estate brokers are any indication, the demand for new and renovated space has remained consistent with the trend of growth. What has changed is the confidence of the owners in the near term future. It isn't uncommon for election years to be less robust construction years but there are factors in this election that have had a particularly chilling effect on the willingness of owners to proceed with projects.

Uncertainty about the tax laws, the costs or following through on healthcare reform and a general sense that a second Obama administration will work to distribute more business profits to government programs are a few of the concerns that are giving business owners pause, even in the midst of improved performance. For small businesses this is especially true, since the profits from their businesses pass more directly to the owners themselves. The fear that the tax on those profits may be going up significantly next year could make a big difference in whether or not the profits are reinvested or drawn out in 2012 to take advantage of more favorable rates.

Construction has begun on several of the office projects that have been in the headlines for the past half year. The new $50 million Mylan Headquarters at Southpointe, the 90,000 square foot Cranberry Crossroads office being developed by Elmhurst Group and the Tower at PNC Plaza have all started or gone out to bid since the first quarter. Less than 50,000 square feet of that space is available for lease, however. Corporate users of space from 70,000 square feet to over 250,000 are looking for space in all corners of the region, but there are few that will develop fast enough to improve the prospects for 2012.

The strongest sector of the market for construction in 2012 will remain the natural gas industry as the development of midstream processing and distribution continues in spite of the low commodity prices. Perhaps the most optimistic words about the future should come from that sector.

Michael Williams, former chairman of the Texas Railroad Commission, the regulatory body for oil and gas development and production in Texas, shared Texas' experience with gas production and the economic impact of building ethylene "cracking" facilities at a June 5 seminar put on by dck Worldwide and Leech Tishman Fuscaldo & Lampl. Williams compared the recent development of the Marcellus Shale to the boom created in 2002 by the development of the Barnett Shale formation in north Texas, which continues to produce seven percent of the country's natural gas. Citing the economic studies of the Barnett Shale by the independent Perryman Group, Williams said the Barnett play has created 109,000 jobs and $80 billion output generated to date in Texas. Cracker construction, Williams said, "will create jobs in every neighborhood," referring to the array of professional and journeyman skills needed for construction of roads, pipelines, and buildings, and in support and auxiliary services like health care, hospitality, engineering, and sanitation. BG

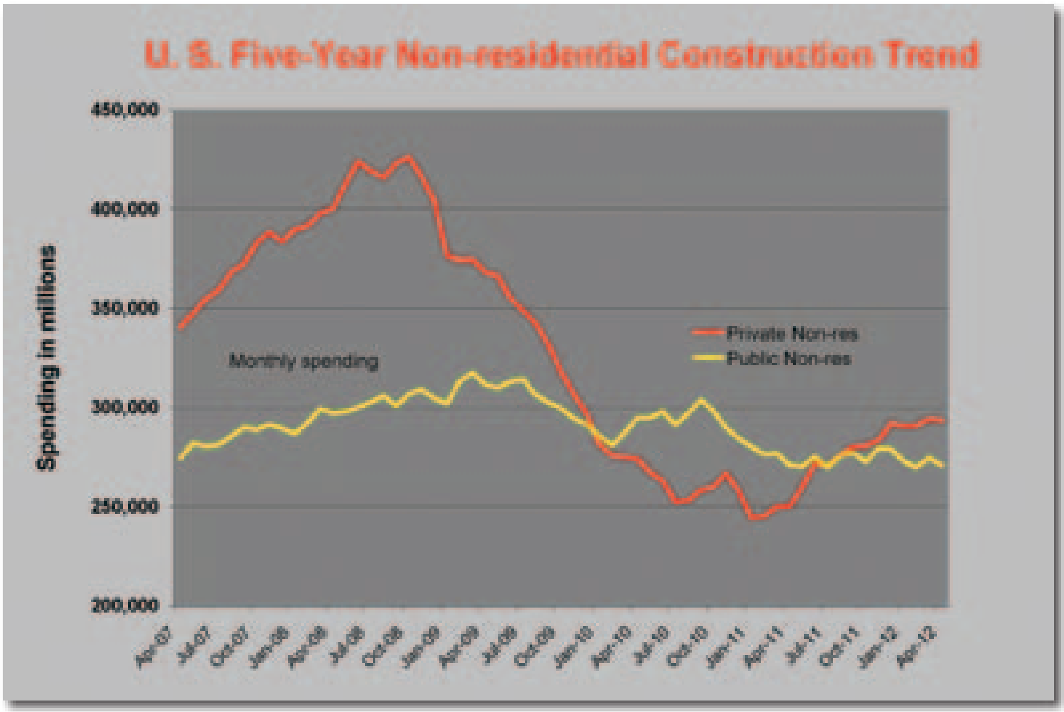
NATIONAL MARKET UPDATE

For the U. S. economy it's Ground Hog Day 2012. In both 2010 and 2011 there were Christmas season spending surprises followed by great first quarter earnings. But in late April and early May came an unsettled stock market (remember the 'flash crash' of May 2010?) then the fear of European Union collapse and a reprise of the global financial crisis. Each year's spring fears led to a 15 percent summer correction in the stock market and even more fears that the economy was going to go backwards.

Of course both summers were followed by fall/winter recoveries in gross domestic output, employment and stock prices. Even the embarrassing Congressional/Presidential debt debacle and debt downgrade didn't hold back recovery for long.

As June 2012 winds down, the economic symptoms are still indicating weakness rather than health and the symptoms are basically the same as the past two summers. Europe is in default and the question is how much forgiveness is needed to keep the EU together. Employment growth has halted, with more than half the jobs lost in the recession still unrecovered. Congress and the Obama administration have done little to address the federal fiscal woes except to blame the other side. Action on the debt ceiling appears to be another half year away but in its place is a bigger question mark: the presidential election. Like the previous two summers the real drag on the economic recovery is more emotional than economic. It is uncertainty.

It is not that the uncertainty is invalid. Absent more reassuring data there are significant unanswered questions facing businesses and consumers. Are global financial institutions in the same precariously exposed position as in 2007? Have U. S. banks written down or taken reserves for their exposure to European default? Are all European nations but Germany insolvent? Will a steep recession in Europe trigger a slowdown and then a popping bubble in China? Have enough homes finally been foreclosed that the values of homes are going to begin to climb again? Will an Obama re-election liberate the administration to ratchet up taxes on the investment class and shift capital through government spending? Will a Romney election trigger a sea change in government policy and cause recession as the economy adjusts to the loss of its biggest and best customer: the government?

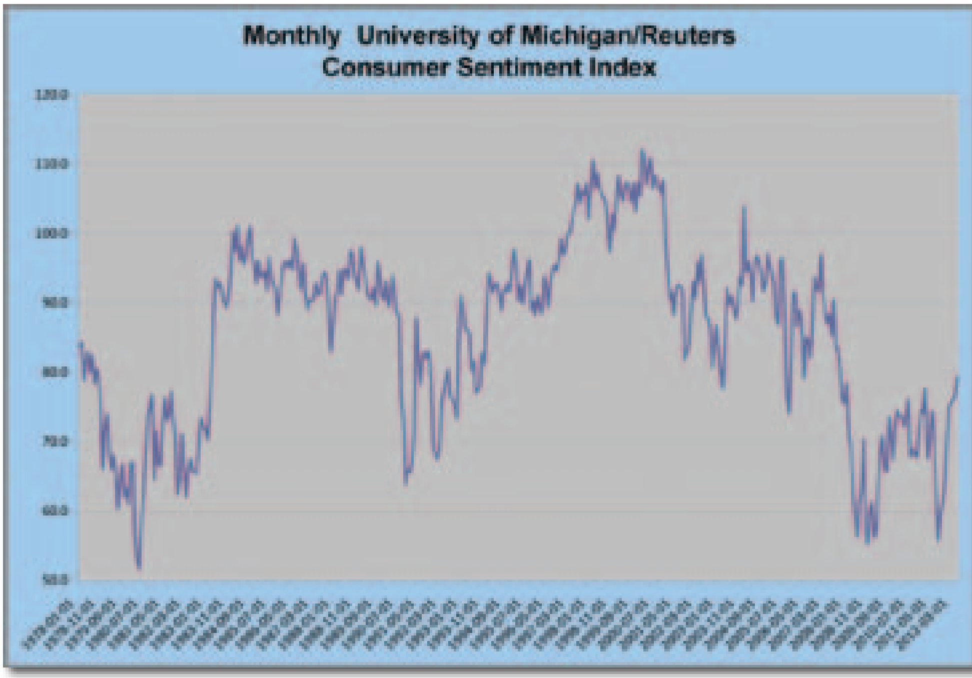


The answers to these questions won't be clear until years have elapsed. But there are a few concrete facts that can give us clues.

Financial institutions are not exposed to loan default as they were in 2007 but many are still leveraged to debt that isn't likely to pay back. After taking provisions for bad loans from strong earnings over the past few years most American banks have put the mortgage crisis behind them but almost no banks have addressed how coupled or uncoupled they are to any write downs of sovereign European debt.

Germany may be the only nation in Europe that has a solvent government but it is to the Eurozone what China was to the U. S. in fall 2008: too deeply tied to walk away. If the EU were to implode the value of the Deutsche Mark would sky rocket, leaving German goods and services unaffordable. Such a result would trigger a deep recession in Germany. History suggests that the Germans may tolerate such a recession to regain control and normalcy, but it's more likely that Prime Minister Merkel's government will do what it can to keep the EU together.

Regardless of the outcome of the U. S. elections, there are some budgetary measures that are already impacting construction. As a buyer of design and construction services, the



Consumer sentiment has recovered to levels last measured at the end of the 2004-2007 growth cycle.

government has been a more selective customer over the past few years. Projects aimed at high priority agencies like the Veterans Administration or specific defense installations have seen healthy spending but construction by the General Services Administration, Bureau of Prisons and Defense generally has declined. Recent guidelines issued by the Office of Management and Budget have also put a pinch on the government's consumption of private real estate as a tenant.

The OMB directed all federal agencies to reduce their real estate footprints and froze the amount of space being rented. The directive encourages the disposition of excess property, reduction of leaseholds, re-negotiation of rents and other efficiencies aimed at reducing the governments' rental expense. CoStar estimates that the OMB initiatives already in place have trimmed $1.5 billion in real estate costs from the budget thus far and anticipates the new directives will identify another $3.5 billion in costs to cut. On the heels of that directive, the IRS announced their own initiative on May 22 that is expected to eliminate more than one million square feet of office rented by the agency. Federal downsizing programs will hold back recovery in the office markets, like the Mid-Atlantic cities, which have high government occupancy.

If the government does indeed become a reduced consumer of construction – and with state and local government already steeply reduced – there will be even more reliance on the private sector for re-starting the U. S. growth engine. And the private sector starts with the consumer.

Consumers have been fairly resilient over the past three years and the data on consumer confidence and spending thus far shows continued resilience. The University of Michigan/Reuters Consumer Sentiment Index has recovered thoroughly from last summer's shocks to approach pre-recession normal levels and spending was ahead of last year's levels by almost three percent through April. Because of the lag in the data there is no evidence yet of how the slowdown in the economy in April and May will affect spending but the coinciding decline in gasoline prices should provide relief to consumers.

The continued recovery in the U. S. housing market has buoyed consumer spending in 2012. Many more markets are experiencing price appreciation again than are still seeing declining home values, although the appreciation is in comparison to much lower prices than a few years ago. Likewise,

IF THE GOVERNMENT DOES INDEED BECOME A REDUCED CONSUMER OF CONSTRUCTION – AND WITH STATE AND LOCAL GOVERNMENT ALREADY STEEPLY REDUCED – THERE WILL BE EVEN MORE RELIANCE ON THE PRIVATE SECTOR **FOR RE-STARTING THE U. S. GROWTH ENGINE. AND THE PRIVATE SECTOR STARTS WITH THE CONSUMER.**

employment is nearly two million jobs higher than in 2010 but job growth has stalled. The Bureau of Labor reported a slowdown in jobs created in May to 69,000. Surveys of employers in June indicate that most still plan to add to staff during the second half of 2012 but the current hiring is less than half the activity that boosted confidence during the winter months.

Data in April also showed that consumer debt increased for the eighth consecutive month, although by about half what was expected. The $6.5 billion increase in borrowing was also limited to non-revolving debt, such as auto or student loans. Credit card debt, which typically grows as consumers buy goods, actually fell by $3.4 billion. A renewed trend in declining revolving debt will mean tougher times ahead for retailers.

Construction data from late June shows a continuation of the three-year roller coaster in monthly starts.

The Department of Commerce's report on April starts shows continued growth in private non-residential and residential activity, with non-residential up 17 percent and residential growing at a 7.5 percent rate compared to April 2011. Government spending showed another decline to 3.2 percent less than the year before.

Reed Construction Data reported that the value of nonresidential construction starts increased 11 percent from May 2011 to May 2012 and 19 percent for the first five months of 2012 compared with the same span in 2011. For the first five months commercial starts were up 41 percent, with gains of 63 percent for retail, 17 percent for private office buildings and 114 percent for hotels and motels. Industrial building starts were down 36 percent, while institutional starts climbed 15 percent. Heavy engineering starts were up 13 percent, with gains in all categories except dam/marine and water/sewage.

Data from McGraw-Hill Construction (MHC) showed a significant decline in May's starts compared with April's but their report was influenced by the start of construction on two massive nuclear plants in Georgia and South Carolina – roughly $8.5 billion each – that skewed the data in the earlier months. "Excluding the lift coming from this year's nuclear power projects, the pattern for construction starts shows a loss of momentum through March, followed by strengthening activity in April and May," stated Robert A. Murray, vice president of economic affairs for the company.

McGraw-Hill reports that with the nuclear projects discounted the pattern for total construction starts would show March down 3 percent, April up 14 percent and May up 4 percent. Unlike Reed, MHC saw a sharp decline in non-building construction for the year, reflecting lower levels of government spending on infrastructure projects. MHC reports that the value of all construction projects is up 6 percent for the first five months.

MHC introduced a 12-month leading indicator for construction spending for nonresidential buildings, called the Dodge Momentum Index (DMI), on May 17. The index is derived from reports of early-stage planning for projects, many of which are turned into starts. MHC says it compared the index to monthly Census Bureau construction spending numbers for 2002-2012 and found the two series move in the same direction 91 percent of the time, with an average lead time of 12 months. As of April the DMI was at 94.7 (2000=100) and the trend indicated improved contracting in the second half of 2012.

CONSTRUCTION DATA FROM LATE JUNE SHOWS A CONTINUATION OF THE THREE-YEAR ROLLER COASTER IN MONTHLY STARTS.

Analysis of the national trends in real estate fundamentals is supporting the forecast of improving construction in commercial sectors. Real-estate analysis firm Dividend Capital Research reported that occupancy rates improved in the first quarter of 2012, while rents were mixed among five property types tracked across more than 50 metro areas. Most property types showed rental growth that was below the rate of inflations and occupancy levels that are less than the long-term average. Dividend Capital found that rents rising rapidly towards new construction levels for apartments, full-service hotels and first-tier regional malls while rents for health facilities were already at the level of new construction. Office and apartment rents rose, as did hotel rates per available room. Retail rents fell and industrial rents held steady.

The status of the U. S. economy is in many ways in a position that is the mirror opposite of its status in summer 2008. Housing is recovering against all odds. The consumer balance sheet and sentiment is much improved even though there has been no real growth since the recession ended. The appearance of health is definitely not obvious (maybe because there isn't economic health) but much like in 2008, when appearance of decline was overshadowed by last gasps of housing bubble hubris, economic recovery may be hidden by dying embers of global fear.

It may be that recovery is missing only confidence to resume growth. The problem facing the economy is that confidence is unlikely to blossom as political leaders posture for election or approval all across the globe this summer. Another fall/winter rebound may lie ahead but a summer boost won't precede it. BG

WHAT'S IT COST?

One of the few upside by-products of the sluggish recovery or retraction into global recession – depending on which fits your world view – is that building material and product prices have begun to respond to the downward pressure. Much like the capitulation that occurs in a stock market selloff, the actions of global manufacturers are those of businesses that have given up on getting price increases to stick.

While neither of the world's two biggest economies – the United States and China – are literally sliding into recession, the demand for construction is still sluggish and prices are reflecting those conditions.

THE PPI FOR INPUTS TO CONSTRUCTION INDUSTRIES, WHICH IS A WEIGHTED AVERAGE OF ALL MATERIALS AND CERTAIN CONSUMABLES USED IN ALL TYPES OF CONSTRUCTION FELL ONE HALF PERCENT IN MAY AND THE YEAR-OVER-YEAR INCREASE HAD NARROWED TO ONE PERCENT.

PERCENTAGE CHANGES IN COSTS	May, 2012 compared to		
	1 mo.	3 mo.	1 yr.
Consumer, Producer & Construction Prices			
Consumer price index (CPI-U)	-0.1	0.9	1.7
Producer price index (PPI) for finished goods	-0.6	0.6	0.7
PPI for construction	-0.5	0.9	1.0
Costs by Construction Types/Subcontractors			
Residential buildings	-0.3	0.9	1.9
New industrial building construction	-0.1	0.4	3.1
New warehouse construction	0.2	0.8	4.2
New school construction	0.1	0.6	4.3
New office construction	0.2	0.4	3.4
Concrete contractors, nonresidential	0.1	0.4	1.4
Roofing contractors, nonresidential	0.3	0.9	4.4
Electrical contractors, nonresidential	0.0	-0.7	3.2
Plumbing contractors, nonresidential	0.2	0.5	2.9
Costs for Specific Construction Inputs			
#2 diesel fuel	-3.6	-1.1	-0.2
Asphalt paving mixtures and blocks	0.0	1.3	6.2
Concrete products	-0.4	-0.2	1.3
Brick and structural clay tile	-0.6	0.1	-2.9
Plastic construction products	-0.7	1.1	3.6
Gypsum products	1.2	1.5	13.6
Lumber and plywood	2.2	5.3	7.0
Architectural coatings	0.0	-0.1	11.8
Steel mill products	-0.9	-1.3	-3.0
Copper and brass mill shapes	-1.6	-3.8	-8.3
Aluminum mill shapes	-1.9	-1.7	-9.0
Fabricated structural metal	-0.3	2.8	4.8
Prefabricated metal buildings	0.1	0.0	-0.7
Crude petroleum (domestic production)	-7.6	-6.8	-5.5
Asphalt (at refinery)	2.1	8.3	16.3
Cement	-0.3	-0.3	1.1
Iron and steel scrap	-1.0	-1.8	-4.8
Copper base scrap	-0.7	-0.8	-4.2

Source Bureau of Labor Statistics, Updated June 19, 2012
Compiled by Ken Simonson, AGC Chief Economist

The Bureau of Labor Statistics (BLS) reported on June 20 that their producer price index (PPI) for finished goods fell 0.6 percent in May, not seasonally adjusted (one percent when seasonally adjusted) and rose merely 0.7 percent over the previous 12 months. The PPI for inputs to construction industries, which is a weighted average of all materials and certain consumables used in all types of construction fell

ENR Building Cost Index 20-City Index (1913=100)	Jun-12 Index	% Change Month	% Change Year
Building cost	5169.5	0.1%	2.2%
Skilled labor	8850.78	0.0%	1.6%
Hourly wages	$ 49.12	0.0%	1.6%
ENR Building Cost Index	Jun-12 Index	% Change Month	% Change Year
Construction cost	9291.4	0.0%	2.6%
Common labor	19686.45	0.0%	2.5%
Hourly wages	$ 37.40	0.0%	2.5%
ENR Material Cost Index	Jun-12 Index	% Change Month	% Change Year
All materials	2920.24	0.1%	3.3%
Cement ($ per ton)	$ 107.51	0.1%	4.0%
Steel ($ per hundred pounds)	$ 50.38	0.0%	5.6%
Lumber (4 per million board feet)	$ 395.02	0.5%	-3.1%

one half percent in May and the year-over-year increase had narrowed to one percent.

Fueling the decline in costs were the commodities that contributed the most to earlier price inflation. Among the most notable were diesel fuel (down 3.6 percent for the month and 0.2 percent over 12 months) aluminum mill shapes (down 1.9 percent and 9 percent), copper and brass mill shapes (down 1.6 percent and

AMONG THE MOST NOTABLE WERE DIESEL FUEL (DOWN 3.6 PERCENT FOR THE MONTH AND 0.2 PERCENT OVER 12 MONTHS) ALUMINUM MILL SHAPES (DOWN 1.9 PERCENT AND 9 PERCENT) ...

DRYWALL REMAINS THE ONE CATEGORY THAT IS HOLDING ONTO AGGRESSIVE INCREASES FROM THE WINTER, ALTHOUGH AT 14 PERCENT YEAR-OVER-YEAR THE PRICE INCREASE HAS ERODED SOME.

8.3 percent), steel mill products (down 0.9 percent and 3 percent) and brick and structural clay tile (down 0.6 percent and 2.9 percent).

With the price of crude oil falling even further since the collection of data in mid-May, the price of diesel fuel – which had already fallen 27 cents per gallon to $3.73 by mid-June – should fall significantly below last year's levels by end of summer. Such a decline will have a rippling effect throughout the industry, which is dependent upon transportation of heavy materials and high diesel consumption.

Among the products and materials that experienced declines from April to May but were still higher than a year earlier were concrete products and construction plastics. Several key items were higher both in May and year-over-year. Those include lumber and plywood (up 7 percent in 2012), architectural coatings (up 12 percent), asphalt paving (up 6.2 percent) and insulation (up 5.2 percent). Drywall remains the one category that is holding onto aggressive increases from the winter, although at 14 percent year-over-year the price increase has eroded some.

The long-term outlook for steel costs has become more favorable since winter as well, with demand slowing and manufacturers building capacity in selected steel products. Among the structural shapes and sizes, reinforcing bar appears to be the only product with sustainable pricing. The new capacity includes the $225 million Timken Steel plant expansion in Canton, OH, the USSteel pipe plant upgrade in Lorain, OH, and the $1.2 billion Tianjin Pipe Corp. plant in Corpus Christi, TX that can produce 500,000 tons a year. BG

There aren't many analogies or past experiences from similar situations that can easily describe the status of the office and industrial markets as the middle of 2012 passes. For certain there have been sluggish recoveries from other recessions, rapidly rising rents, tight credit conditions and periods where demand outstripped the supply of space. There just haven't been periods where all these happened at the same time.

It is not a coincidence that the professionals who make their living in commercial and residential real estate find themselves with the exact same complaint about their business: not enough product.

Office and Industrial Market UPDATE

Part of what happened was the good fortune that Pittsburgh-based banks had been largely out of the businesses that brought institutions like Lehman Brothers, Wachovia and National City down. One of the winners in the financial services recovery was PNC and their growth in the aftermath of the crisis has fueled the absorption of more than a million square feet. Similar results came from Westinghouse and the University of Pittsburgh Medical Center. The success of these companies flowed down through their supply chains. The impact on the office and industrial markets was not subtle.

In the first three quarters of 2010 alone more than 1.3 million square feet of office space and 2.26 million square feet of industrial space were absorbed.

That year the regional real estate market also began to feel the real impact of the natural gas exploration that was hitting its stride. By the end of that year and into 2011, companies that worked in the natural gas industry were beginning to gobble up space voraciously. Businesses that had little or no presence in Western PA as recently as 2008 were now renting hundreds of thousands of square feet along I-79 or the Parkway West. Of the small number of new office or industrial buildings that were built during this period, virtually all were build-to-suit deals for an energy company.

With developers having neither the appetite nor the financing to speculate on new commercial space, the stage was set for the current status. Simply put, there's not enough space.

The idea that there would be a shortage of inventory of commercial space – or homes for that matter – was unthinkable just a couple of years ago. The recession killed demand for all types of commercial real estate and in many regional markets the bubble of the preceding years created an overhang that could not be absorbed in three or four years. In Pittsburgh, the bubble didn't really happen so that the recession didn't catch quite so many owners and developers with excessive inventory. But the wrenching nature of the crisis of fall 2008 chilled the demand for space.

Against the backdrop of the terrible national real estate crash and the daily negative headlines, however, the occupancy rates in Pittsburgh didn't suffer a major drop. The recession took its toll on regional employers for sure, but the vacancy rate in office buildings and warehouses in metro Pittsburgh didn't spike. During the middle years of the decade the improving economic health of the region had pushed office vacancy rates down into the low teens, with industrial vacancy at a slightly lower rate. When the financial crisis hit for example, the vacancy rate for offices was around 11 percent (or 17 percent for researchers who counted offices destined for future re-use). Two years later, those rates were roughly the same. Few, if any other U. S. cities experienced similar market dynamics during those two years.

INDUSTRIAL MARKET UPDATE

If the gas industry sneaked up on the regional consciousness during 2009 and 2010, it was no secret to the industrial real estate community.

The epicenter of the Marcellus Shale play was Canonsburg. As early explorers like Atlas and Range Resources began drilling in the area, businesses in Washington County began to take notice in all the ways that the industry touts in its commercials. Diners were hopping; tire stores sold out truck inventories and hotels were overbooked. And from Canonsburg to Uniontown real estate brokers were tasked with finding "15,000 square feet of shop and a five acre yard" for the drillers and the ever-growing number of companies in the supply chain of the gas business.

Three years later the searches are a bit different. The supply chain is getting more fully entrenched as the activity moved from upstream to midstream in the gas fields. The Marcellus (and now Utica) play has attracted the big global players by now. The industry is going through consolidation and the space requirements have expanded. Over the past two years there have been a dozen or more new buildings built in the high demand locations along I-70 and I-79, varying in size from 20,000 to 100,000 square feet. From New Stanton to Burgettstown, small and underutilized industrial parks have been filling up. One new building, developed by LaCarte Enterprises for Gardner Denver Nash in the Alta Vista Business Park is expanding by 10,000 square feet even as the tenant takes occupancy.

Assuming that the trajectory of the natural gas industry continues as anticipated, the demand for industrial space now pales in comparison to what will be needed when the downstream industries fall in behind in the years to come. Aside from the prosperity that has followed in the wake of the exploration, the evolution of the natural gas industry has acted as a catalyst to solve one of the region's more significant industrial development problems: the lack of sites.

When a group of site selection experts visited the region in 2007 and 2008 their message was very clear about what the region lacked and that was more pad-ready industrial sites. The inventory of sites is not unlimited but in the intervening years efforts to boost the pad-ready inventory have paid off.

"Five years ago I couldn't have said this but we are able to meet the market in pretty much any direction," notes Lou Oliva, senior vice president and managing director of Newmark Grubb Knight Frank in Pittsburgh. Oliva specializes in industrial property and points out those investments in recent years have created choice for developers. "Out the Parkway West and 576 there have been various infrastructure investments so parks like Westport can offer users sites. There are sites to do 100 acres or 10 acres and anything in between."

Investments in infrastructure have come from both private and public sectors. The projects have included the addition or expansion of interstate highway intersections and the construction of roads and sewers inside proposed industrial parks. In a number of cases the county industrial development corporations have been in the lead to get sites ready for market.

The development corporations in Washington, Fayette and Westmoreland Counties all had impetus from the early stages of the Marcellus Shale exploration. In Fayette County, the Fayette Business Park, which is located right off I-43 near a Norfolk Southern rail line south of Fairchance, was originally the site for some of the defense-related companies that started up in the 2000's but the activity shifted to companies like Atlas (now Chevron) and CalFrac, which have large facilities in the park. Fay-Penn Economic Development Council estimates that there are 1,000 jobs in the business park now.

Washington County focused resources on the I-70 corridor, getting Alta Vista more pad ready and working to establish parks like Starpointe and of course, Southpointe II. These days the county's location makes it attractive enough that future investment will likely be from the private sector and the government's role will be to advocate and resource improvements to highways and sewers.

There was a burst of activity in the Westmoreland County industrial parks in the 1990's that gave way to slower growth but the arrival of the gas industry mobilized their IDC. Like in Washington, the focus of the efforts in Westmoreland was I-70. "I think there are probably enough sites along I-70 for five to seven years," says Oliva. "The Westmoreland County Industrial Development Corp. has been one of the most proactive of the county IDC's."

While the recession cooled off the momentum for new construction and financing pinched the flow of capital for a few years, some private developers have been advancing large industrial projects, taking the time for infrastructure ahead of the perceived recovery.

The Buncher Co. used 2011 to tackle the site work and first roadways for their Jackson Pointe Commerce Center to the north of Cranberry in Jackson Township. Construction is well along on the first 69,000 square foot building of what will eventually be 340,000 square feet of industrial space. Chapman Properties similarly used the unintended downtime caused by the recession to prepare the infrastructure for the Chapman Commerce Center, a two million square foot development at the Westport Road intersection of I-576 near the Pittsburgh International Airport. Almost all of the planned space will be industrial or distribution.

"We're in the middle of putting together our marketing campaign and architectural plans for the first building," says Steve Thomas, Chapman's president and owner. "I envisioned the first 95,000 square foot building to be spec back in 2006 but of course spec went off the table. The bottom line is that I'm aggressive but not stupid."

Thomas says that the roads and sewers to get the first buildings going are in place, an investment of $2 million. The site preparation has made a 60 acre pad available for a deal now, although Thomas feels that the construction will take place on the first building later in 2012 or in early 2013. Like other parts of the commercial market in mid-2012, the industrial sector is suffering from user indecision. There are a handful of big users shopping for space right now, several in the broader airport area, but getting commitments in a period of uncertainty is difficult. And part of the problem is that there aren't many options, especially for larger needs.

The Pittsburgh industrial market had a vacancy rate that was roughly 10 percent when the recession started and has fallen to 8 percent as of June. For some of the reasons stated earlier, the demand for industrial space has remained steady or improved and very little space has been added to the market that wasn't built-to-suit. You might think the scarcity would be a motivator for users to cut deals but if you consider the psychology in an uncertain time the problem makes sense. Decision makers look for lots of support if there is uncertainty when they are shopping. In the same way you might shop for a car when you're unsure if you can afford it – by looking at lots of cars to get comfortable with the deal – a potential tenant would like to look at more spaces before feeling comfortable about a decision to rent. And that's just not possible right now.

To give an example of the scarcity, brokers Rob Blackmore and Rich Gasperini of CB-Richard Ellis did some research recently to find the available options for an 80,000 square foot user that needs 24 foot clear light industrial space. The result was three buildings with very incompatible qualities: 460 Nixon Road in the Allegheny Industrial Park, the Gateway View Plaza near the West End and Building 550 in Leetsdale Industrial Park. Gasperini says that the situation isn't a commentary on the quality of what has been built but on the market conditions behind the construction.

"What has been delivered here over the last three years has been for the most part pretty high quality construction but there's been very little delivered," he explains. "And I don't think anything else will be done spec between now and the end of 2012."

In fact, a check of the research reports done by the regional industrial brokers – CBRE, Newmark Grubb, Colliers, Grant Street and PA Commercial – shows roughly 250,000 square feet under construction in the second quarter with another 200,000 square feet to be delivered this year. The information compiled in the Tall Timber Group's database of construction starts shows 1.7 million square feet has gone to construction since January 2011. But the amount of that product that has been commercial space for rent has been less than ten percent. Aside from the Buncher project in Jackson Township, a 50,000 square foot building was erected in the Westmoreland Airpark by the Ridilla Family Partnership. The remainder was either build-to-suit deals or owner occupied industrial facilities.

And the users are out there. Newmark Grubb's Oliva hinted at a client with a 200,000 square foot requirement that was close to signing a deal. Agents for two industrial parks in southern Beaver County recently spoke of being in discussions with a different 200,000 square foot user. Calgon Carbon, Ensinger Plastics and Carpenter Steel have all been looking with various degrees of intensity at sites along I-79 and I-376. CBRE reports that they are tracking 4.5 million square feet of user requirements in the market. While some of those companies have been in the market for multiple years, they estimate that more than one million square feet will be inked this year, assuming that much space can be found.

When the momentum for new construction does return there are a few other large parks moving forward that will give companies options.

Across the Findlay Connector from the Chapman site, Imperial Land Corporation has developed plans for two large industrial sites. Findlay Industrial Park is a 400-acre development, which already houses facilities for Appliance Dealers Group, Okonite and Alro Steel. More than 300 acres remain available in two phases of total development, which can accommodate buildings up to 1 million square feet. To the south of Findlay Industrial Park is Westport Woods, which is smaller at 100 acres but can accommodate buildings over 100,000 square feet and a total of one million square feet.

Just a few miles to the south, Imperial Land Corp. owns another 2,000 acres along Route 980 in Robinson Township of Washington County. No immediate schedule for development has been announced but the site is positioned well to take advantage of the future completion of the Southern Connector of the I-576 highway. The park, along with Imperial Land's Findlay Township properties are also well positioned to attract future businesses looking to be conveniently located between the gas fields in the heart of the Marcellus Shale, the airport and the coming Beaver County petrochemical plants.

Also ideally situated to serve the developing gas industry is the Starpointe Industrial Park in Hanover Township, near Burgettstown. Fourth River Development is developing the park, which is located along Route 22 near the Findlay Connector intersection. Fourth River recently had success in attracting industrial door and dock manufacturer Flexon to Starpointe, selling them 10 acres to build a 68,000 square foot plant. Fourth River's plans for Starpointe's second phase are more ambitious than its Phase 1, which still has seven lots available. Starpointe's Phase 1B has been designed to accommodate 1.4 million square feet of space, including three buildings of more than 225,000 and a 570,000 square foot facility.

At the other end of the spectrum from these suburban and rural properties is the Almono site being developed by the RIDC between Second Avenue and the Monongahela River in the Hazlewood section of Pittsburgh. The master plan for Almono is a mixed-use project with residential units, green space and commercial buildings. The project calls for almost 800,000 square feet of industrial space, although the intent is to attract clean technology and advanced manufacturing that are compatible with mixed-use, says RIDC president Don Smith.

The project is a massive brownfield redevelopment, with tens of millions of dollars needed for infrastructure but the site also allows for construction on some of its existing property. "There's an outside chance you could see buildings going up next year because we can build on some sites at Almono," Smith explains. "But it's more likely that we'll take the next year to do the engineering, zoning and get permits to start construction and have some pads ready for building by 2014."

For a region gearing itself up for an industrial revival based on natural gas and chemicals, waiting another two or three years for significant sites to be ready may be a bit deflating but the market isn't looking for that explosion just yet. In between now and then there will continue to be opportunities for the 50,000 to 100,000 square foot business to expand, once there is confidence in the direction of the economy again. If recent history is any indicator, that could come as soon as this fall.

"When confidence and certainty return you'll see people moving up to higher quality buildings and more space," predicts Gasperini. "I think you'll see businesses going from Class B and C to better buildings, moving from Crafton to the Parkway West."

OFFICE MARKET UPDATE

While it's not exactly that simple, the dynamics of the office market are very similar to what has happened to the industrial market in terms of supply and demand.

One big difference between office and industrial development has been the availability of sites. Whether it was greenfields, brownfields or infill, office parks and land for office development has been ready for new construction. What has held back new development since 2008 have been the same factors depressing industrial development in Pittsburgh or office development in all parts of the country, low demand and tough financing conditions. Like Western PA's industrial market, demand for office space began to rebound well ahead of other regions because employment began to rebound faster.

In addition to the improved employment outlook, office demand also benefitted from the fact that Pittsburgh was home to some very hot employers that were expanding and needed more space even faster than the overall market. PNC and UPMC gobbled up large chunks of Class A space and neither show signs of a diminishing appetite yet. What really helped the office market was also that the expansion of the natural gas industry hit as the recovery was getting underway generally. As that industry evolved, the smaller companies that arrived early became acquisition targets for the global energy giants that consolidated the industry. In 2010 and 2011 names like Chevron, Shell and Exxon entered the market,

Photo by Armstrong Co. Industrial Development Council

along with continued growth among the consolidating players in the supply chain like MarkWest and Williams.

Activity has slowed as the second quarter ends but the vacancy rate in the market continues to be well below the national norm. According to CoStar's report on the first quarter, the office vacancy rate fell to 8.4 percent in the metropolitan area as compared to the 12.2 percent national average. Net absorption in Pittsburgh was 278,258 square feet. CoStar was also tracking 574,609 square feet of office under construction. Regional brokerage reports list the overall market as having a higher vacancy rate of between 12 and 15 percent, but all have Class A vacancy at 10 percent or lower.

It is worth drilling down into the details of the research a bit. By looking at the sub-market vacancy rates you get a clearer picture of the good news/bad news about the market. On the plus side is the fact that the high growth areas – Oakland, Cranberry, Southpointe and downtown – have very low vacancy rates. The first three are in the range of five percent, plus or minus, but even the square footage that is vacant is so scattered that there is effectively no contiguous space over 7,000 or 8,000 square feet. Downtown's vacancy rate is higher but it may be effectively tighter because the downtown user is looking for larger spaces than in the suburbs and contiguous spaces of more than 40,000 square feet are extremely rare in town right now.

Like the industrial market, there is no significant help coming in the form of new construction. Going back to the beginning of 2011 there has been a similar amount of office space started – roughly 1.6 million square feet – as industrial property, yet even less of it has been available for lease.If you own a building the news is good but if you're looking for space, not so much.

"For office space the product is virtually non-existent in the north, south or west right now," says Rob Geiger, principal at Grant Street Associates/Cushman & Wakefield. "There are some nice blocks of space in the east that could accommodate 100,000 square feet or more but there's not much else existing."

Gerry McLaughlin, senior vice president at Newmark Grubb agrees. "Right now what we could use is some products, especially in the suburban northern and southern markets. I think we've lost some deals because of it," he notes. "With that said there seems to be a bit of a break with the economy slowing. The velocity is definitely different from the first quarter."

The summer caution that seems to have taken hold has cooled off the activity for big users of space, say 75,000 square feet and up, although all brokers seem to agree that there is still a number of users looking in the range of 10,000 to 30,000 square feet, a fact that is attributed to the growing supply chain for gas companies and Westinghouse. The slowdown could actually work in the market's favor, since it would give developers an opportunity to bring new office buildings on line by the end of next year. Of course, that would require a bit more loosening of the financing conditions.

While conditions have improved, there isn't evidence to suggest that lenders will be reverting to pre-recession standards. "For an office building I think you're still looking at 55 to 60 percent pre-leased, lease in hand" says Paul Griffith, managing director for Integra Realty Resources in Pittsburgh. "I haven't heard of anyone loosening up their standards yet."

Still, the tight market has motivated a number of developers to pull the trigger on new development. Jendoco Real Estate has begun construction of a 23,000 square foot flex office in its Settlers Cabin park. And developers Elmhurst Group and Chaska Property Advisors are each moving forward with new buildings in two of the region's hotter submarkets.

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Chaska's Cranberry Business Park has been virtually fully leased as it has developed over a decade or more. While currently finishing up Building 300, Chaska is planning another building there and a new project – called Pittsburgh International Business Park – in Moon Township. Chaska's CEO, Dick Donley feels the timing and location are right to ramp up development.

"The airport market over the past two years has shown incredible strength. You have the Williams deal, the two buildings that Sam DiCicco sold, and the solid employment base of companies like Eaton and Dick's," Donley says. "We were blessed in finding something extremely unusual [in Moon]. It was a site that was expertly planned and executed by a government entity – the airport authority and Randy Forister – that suits the project perfectly."

In a market that is still unfavorable to speculative financing, Donley is committed to going ahead with a spec building at the airport site in fall 2012 and starting the entitlement process on a 63,000 square foot office at 290 Cranberry Business Park in spring 2013. Elmhurst is also moving forward with speculative projects in Cranberry Township. Already under construction is a 90,000 square foot office at the new Cranberry Crossroads development on Route 228 and getting underway is the first of twin 48,400

other new projects. The firm is marketing The Concorde, a 60,000 square foot office in the RIDC West, a 40,000 square foot medical office at Green Tree Road and the Parkway West and a 300,000 square foot office building along the First Avenue corridor downtown.

All of these potential projects are located in attractive sub-markets with established sites, which will allow for development as soon as the desired pre-leasing levels are reached. But for users or developers looking for fresh sites the market conditions are creating another development problem and that is fewer land deals. The land is certainly there but the expansion of natural gas drilling has changed the perception of land values, at least for the property owners.

"If you're looking for land for a new building or project there is land out there but a lot of the land owners are pricing themselves out of the [real estate] market," says Rob Geiger. "That can be a limiting factor to expansion for our corporations."

One sub-market where both land and space are limited is downtown. The short supply of space has pushed rents steadily higher and has created an unusual situation with respect to how space of lower quality is being regarded. For years much of the smaller Class B and C space has been taken off the market by Point Park University and by the Cultural Trust on the other side of the Triangle. Now with Class A space unusually tight, several of the larger Class B buildings that may have otherwise been relief valves are being re-purposed. This includes venerable buildings like the Oliver and Reed buildings and the former ALCOA headquarters, more recently known as the Regional Enterprise Tower, all of which will be mixed use after renovation. And it leaves a project like the Union Trust Building, now 501 Grant Street, somewhere in between B and A status until its renovation can be finished.

Class A rents should be driving the renovation and upgrading of these kinds of buildings but as little as 20 percent of the space involved may be offices when their re-use is completed. The rising rents should also be driving new construction but the costs associated with new downtown office are an issue.

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square foot flex buildings at the Commons at Thorn Hill in the RIDC Park. Elmhurst has also received a permit for its 175,000 square foot Schenley Gardens building in Oakland, a much-needed project that had been sidetracked by the downturn.

At the opposite end of the metropolitan map, two different developers are marketing several hundred thousand square feet of new construction in Southpointe.

Horizon Properties shifted gears on its Southpointe Town Center away from lifestyle retail two years ago and is currently planning a 150,000 square foot office building at that site, as well as a 150,000 square foot office that it expects to start by fall at the Southpointe II property. Also at Southpointe II, a pair of 125,000 square foot offices has been proposed by Burns & Scalo Real Estate Services. Burns & Scalo is taking advantage of the tight conditions to put forward three

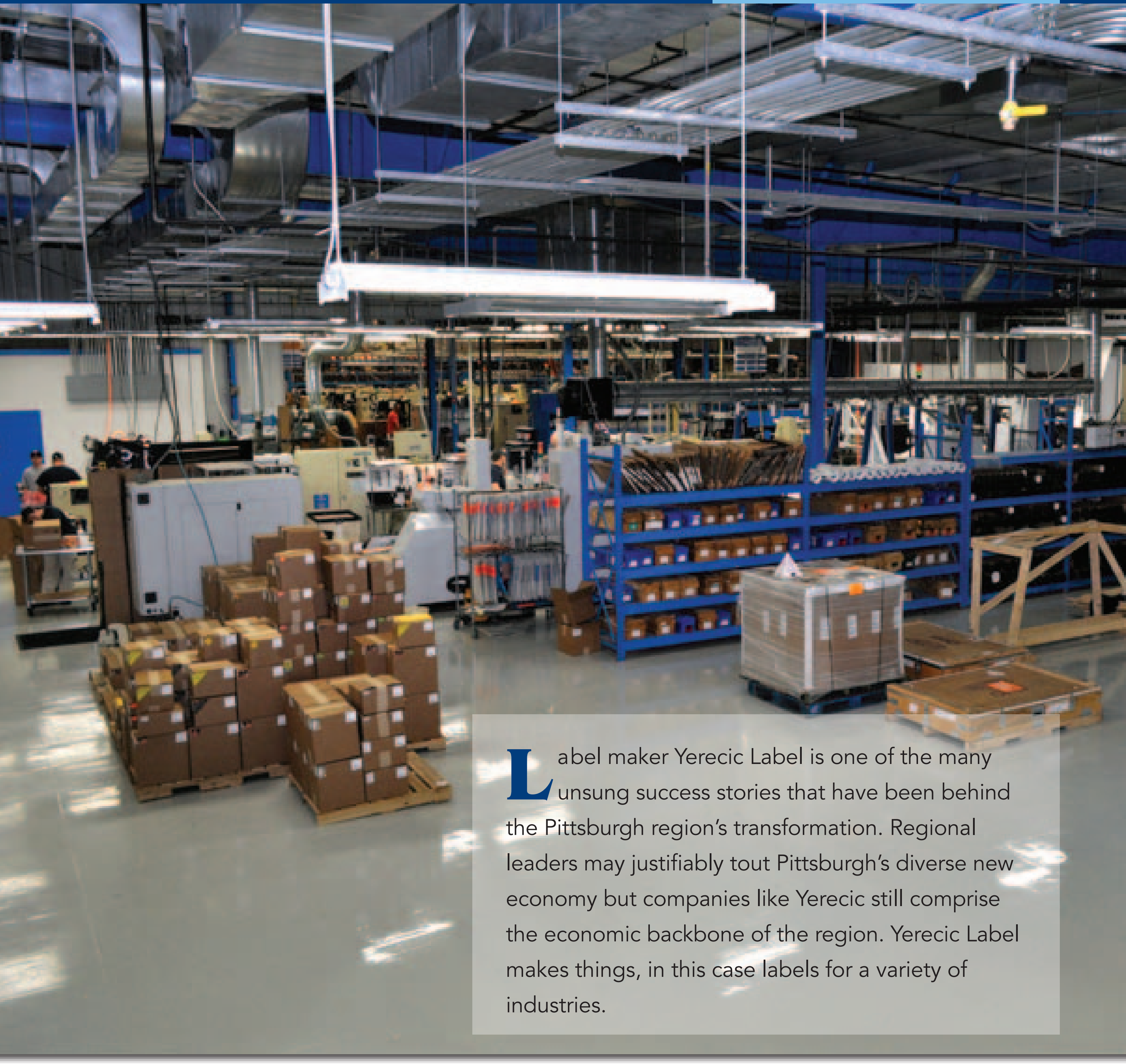
"I didn't know that there was anything but A space anymore," jokes George 'Duke' Kingsley from Avison Young. Kingsley alludes to the fact that classification of space became less defined as it became scarcer. "You would expect new construction now but the rents that you need for that are higher than the market. We're seeing $25, $28 per square foot. I don't know how much higher you can expect to get in a market like Pittsburgh."

Without a recent speculative office to compare it's hard to be precise about the pro forma rents for a new building. The most recent downtown offices have been either owner occupied – the Tower at PNC Plaza – or virtually build-to-suit like 3 PNC Plaza. Using the construction costs that have been announced by Millcraft Industries for its Gardens project or Oxford Development for its 350 Fifth Avenue project, the rents required for the projects to be viable will be in the $32-$35 range. That's a gap of $7 or $8 from the Class A market now.

"There are some higher rent buildings in town but even at the top – PPG Place or EQT –you're at $29 or $30 per foot," says Gerry McLaughlin. "Maybe for the top floor you can get to $31 or $32 but there's still a gap between that and new construction."

The paradox for the office market is that the regional employment and economic strength is coming from industries like healthcare, emerging technologies and energy, none of which are dependent or even interested in downtown real estate. Assuming there is a break coming in 2013 for the uncertainty that is locking up progress on new construction, the suburbs will see the vast majority of the new construction that takes place. But because of the growth of UPMC and PNC the environment for living and working downtown continues to improve and attract workers. It seems that what is good for the suburbs is good for the city.

"I just read through the Pittsburgh Downtown Partnership's annual report and it's really impressive," says Bill Hunt, Elmhurst's president. "Even if it's 75 percent spin, you can't argue with the data from the market." BG



Label maker Yerecic Label is one of the many unsung success stories that have been behind the Pittsburgh region's transformation. Regional leaders may justifiably tout Pittsburgh's diverse new economy but companies like Yerecic still comprise the economic backbone of the region. Yerecic Label makes things, in this case labels for a variety of industries.

YERECIC LABEL EXPANSION

RSSC had been hired to plan the expansion but as the design process was advancing the economy went into recession. Although their business was weathering the crisis, Yerecic decided to put the project on the shelf. Over the next couple of years, however, Yerecic Label managed not only to survive but to keep growing. In 2010, Yerecic decided they couldn't delay the expansion further, in part because of an attractive tax incentive.

"We had postponed the addition for a couple of years based on the uncertainty but we needed offsite storage facilities to keep up with the business, one for materials and one for finished product," says Art Yerecic Jr. "We pride ourselves on being a lean manufacturer and that set up wasn't very lean. There were also bonus depreciation tax incentives that were a factor too. We didn't have space to store the new equipment and we had to get the new equipment installed and operational by the end of [2011] to get the depreciation."

"We knew a lot about pre-engineered buildings so we were able to make some suggestions about the structure, some changes that made a difference in the price."

The company's success story is typical of American small business. Arthur Yerecic Sr. started making labels in his garage in 1969. His son liked to help him and later joined the business as it grew. In 1993, Art Jr. and Yerecic Label embraced the principles of lean manufacturing and five years later the company consolidated its operations into a new headquarters in the Westmoreland Business & Research Park in Upper Burrell Township. The original plan for the complex included provisions for future expansions as the business grew and by the later part of the following decade the company began thinking about what their larger facility should be like.

Aside from outgrowing their space, Yerecic needed to accommodate the installation of new printing equipment. "In their business, the technology changed on the equipment from the old style of making plates to a completely digital process for making plates," explains Ron Gigler, the project architect for RSSC Architecture, the firm that designed the original building and was working on the addition. "They were seeking to use the project as an opportunity to enhance their corporate image by building an office and operation that they could showcase to clients and prospects."

The decision to proceed was made and the design was prepared but when they received a proposal from a contractor Yerecic had worked with in past the price was too high. Instead of proceeding in November 2010, Yerecic chose to have RSSC finish construction documents and put the project out to bid. Five or six contractors were chosen to bid the project with the intention of bringing in the three contractors who submitted the lowest bids to interview. Since the bids came in over budget the interviews were also going to serve as value engineering sessions. Contractors were told to be prepared to offer suggestions on savings and design.

"We ran this process very similarly to the way we run the vast majority of our purchasing decisions," notes Art Yerecic. "Price is important to us but not if there are other value considerations to consider."

One of the contractors brought in for an interview was Uhl Construction. They had worked with RSSC before and came into the interview with ideas for getting to budget but also with an approach that served them well.

"We sat across the table from them and said we can take this out or that out but there's a reason that some of these things are on the drawings. You must have wanted them on the project," remembers Dave Hengelsberg, Uhl's project manager. "We knew a lot about pre-engineered buildings so we were able to make some suggestions about the structure, some changes that made a difference in the price."

Uhl was prepared to talk about the project differently than the others and that made an impression, according to Gigler. "The owner got comfortable with Uhl and was able to negotiate a fixed price. They saw certain things in the interview that made them comfortable about the negotiations."

Art Yerecic agrees. "Uhl's approach to the value engineering was the key thing for us. We thought their approach was very thoughtful and showed a lot of confidence, especially in the way they advised us about our choices."

That comfort level with Uhl's approach was important because once the project started, the price was not going to be nearly as important as the quality and schedule. The delays in getting a contractor had not been inordinate but six months had passed since they had accepted the first price by the time contracts were signed in May 2011. One of Yerecic's biggest motives for their decision to proceed was a tax incentive that was going to expire at the end of 2011 and no extensions were going to accommodate the delays that had occurred. Either the equipment would be running on December 31, 2011 or the incentive would be lost.

The expansion was a 20,430 square foot pre-engineered steel building with flat metal exterior panels that would house some of the older equipment, new shipping and receiving facilities and a mezzanine for offices that would put supervisors in the middle of the operation. Equally important was the renovation of approximately 21,000 square feet of Yerecic's existing plant, a new outdoor pavilion for employee lunches and activities, plus new parking lots. The key item of the renovation was the preparation of the space for the new equipment. This work would involve well-conceived phasing for what would be a week-long equipment installation by out-of-town vendors during the holiday season.

For a project that needed to hit an inflexible and tight schedule, things got off on the wrong foot because of weather. The late spring of 2011 was especially wet, with heavy rains on consecutive days several times early in the project. One of the problems with the site was that the staging area was limited to a small section of the employee parking lot. The rain meant inconvenience in accessing the site and more damage to the existing site than planned. Another site problem was the poor fill material adjacent to the existing building that was left from the original construction in 1998. The poor soil had to be over excavated and engineered fill brought in to replace it.

"Other than the heavy rain and the site work – we had to bring in 6,000 to 7,000 yards of fill – the project was actually pretty cut and dried," says Hengelsberg. "We had some of the problems any contractor faces on a manufacturing job – access to the site, keeping the place going all the time – but the real challenges were inside the building."

One area where Uhl's confidence definitely showed was in their guidance on painting the floors. Yerecic's printing processes are sensitive to natural light but they needed the space to be well lit. The coating specified was one that Uhl had used before and in this case they felt was not well-suited to the needs of Yerecic's project.

"We had some bad experiences in past with some of the other products chosen so we made the suggestion of a high end epoxy coating that was recommended by Wexford Contracting," says Hengelsberg. "The owner was tickled pink with it. That was the biggest home run for us on the job. You're always sticking your neck out when you go against spec so it was gratifying to have it work out so well for the owner."

"Light is very important on our manufacturing floor," explains Yerecic. "We want to set ourselves apart when customers come to visit. The biggest piece of our business is printing labels for the food and beverage industry so that sparkling clean image is very important to us."

The good communication that occurred during the interviews turned out to be a precursor to the way the project advanced. Yerecic's team included key executives Brian Horst, Linda Ciuca, project manager John Boyer and Art Yerecic. They, along with Gigler and Hengelsberg developed an open style of communication and had routine meetings throughout the project. All parties to the project valued that open communication.

"The communication with all three groups was great. We tried to work closely as architect, owner and contractor," says Gigler. "No matter what issue came up it was addressed and dealt with quickly."

"Being in a team-oriented environment, we really do approach projects as a team. The meetings we had with Uhl and RSSC were very positive and productive," recalls Yerecic. "There's always a lot of tension on a project like this. You're planning the move and everyday business still needed to be handled. I appreciated that any time we needed documentation of any of the issues Dave was on top of it. He never viewed it as onerous or intrusive."

For a manufacturer, having smoothly run processes creates a high level of comfort. The communication and trust that developed gave Yerecic confidence to look for input throughout the job and that created a significant number of owner-directed changes to the scope of the work. For their part Uhl coordinated the work on the renovation portion of the project so that their construction never interfered with production at the Yerecic plant. The communication and coordination would ultimately be put to the test when the equipment changeover occurred in December 2011.

The epoxy coating needed a week to cure before any equipment could be moved. Once the equipment relocation began it was a game of dominoes that couldn't be interrupted without consequences to Yerecic's production and their deadline. The experts from Yerecic's vendors would be in the plant for about a week and during that time all the old equipment had to be moved into the expansion and the new equipment installed in the renovated space. Before all those pieces could fall into place, Uhl faced one of its toughest challenges.

"To hit the schedule we had to get our guys working on the first day of buck season," laughs Hengelsberg. "I just told them 'you don't want to go out on the first day anyway.'"

In the end the schedules lined up. The employee parking lots were paved ahead of the winter. Yerecic got the occupancy permit on December 28, 2011. The existing equipment was moved; the new equipment was installed and the new presses became operational before New Year's Eve. Uhl returned after the worst of the winter weather to finish restoring the site and landscaping, wrapping up in February.

"We're very pleased with the results. We love how the addition looks and works," says Art Yerecic. "We significantly upgraded the floor coating and the lighting in our plant. Uhl came into our existing building and worked with us in phases so that the construction went on and we didn't miss a beat in manufacturing."

PROJECT TEAM

Yerecic Label Inc.	Owner
Uhl Construction Inc.	General Contractor
RSSC Architecture	Architect
Tower Engineering	Mechanical/Electrical Consultant
The Kachele Group	Structural Consultant
Cenkner Engineering Inc.	Civil Engineer
Etzel Masonry	Masonry
Wexford Contracting	High-performance Coatings
Franklin Interiors	Carpet/Vinyl Flooring

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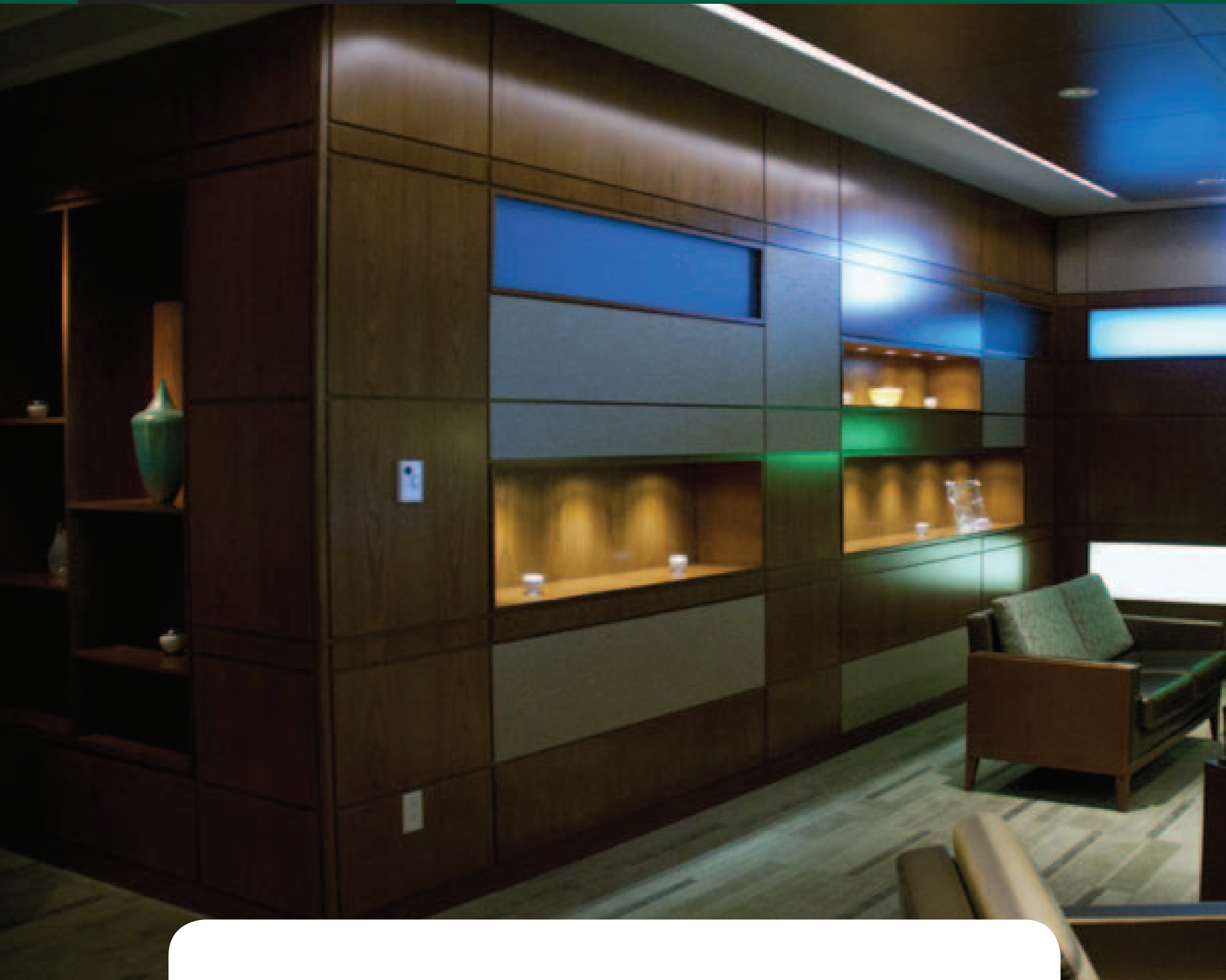

GIFFIN INTERIOR & FIXTURE INC.

"You want to buy a wood shop?" That's Gordon Giffin's joking response to the question of how business is these days. Giffin has steered his millwork and finish shop through a handful of business cycles and knows that a sense of humor and proportion helps him navigate the changes that the industry hands a subcontractor.

Terry Walsh, Monty Gibson, Dustin Giffin and Gordon Giffin.

Giffin Interior is one of those regional gems that you seem to bump into all over Western PA. Their work in the Pittsburgh area is well known by contractors, architects and owners. Giffin has handled the casework and millwork on projects like the new Children's Hospital, Gates/Hillman Center, 3 PNC Plaza and the Rivers Casino. Less well known, however is their work on projects like the Nixon Library in San Clemente, the Inn at the Biltmore House in Asheville, NC, Albert Einstein's office at Princeton University, the East Room of the White House (yes, 1600 Pennsylvania Avenue) and multiple projects at the Bellagio in Las Vegas. In fact, Giffin Interior is the fifth largest millwork contractor in the U. S. At the height of the boom, before the recession hit, Giffin employed as many as 250 people. While he's almost apologetic that the current payroll is 100, Gordon Giffin knows that's larger than most companies in his line of work ever get.

"To me it's about service. That's what we do," he explains. "The products speak for themselves but we're in the service business." Dustin looks beyond the industry for peers and benchmarks with which to manage the business. "We should model ourselves after the biggest and best businesses in the world but we still act like a small company."

Like many small businessmen, Giffin built his company while on his way towards something else.

His formal education was in engineering, first at Bucknell and then finishing at the University of Pittsburgh. The early-to-mid 1970's were difficult economic times, however, so Giffin found himself replying to an ad to complete carpenter's training. Millwork contractor Homestead Cabinet hired him and he spent the rest of the decade learning the business, estimating and installing kitchens. Homestead Cabinet did all of the installation for Sears at the time, but with that work slow, Giffin suggested to the owners of Homestead that they begin to pursue other projects more aggressively. The change in strategy brought the company some more diverse clients, including retail accounts, but Giffin saw more opportunities and decided to launch Giffin Interior in 1980.

Working from his garage initially, Giffin had early success specializing in retail stores. During those early years the company acted as a general contractor for the interior fit-out of stores. "We did the drywall, the ceilings, the casework and fixtures," Giffin remembers. "Most of our customers were the mom and pop stores or specialty retailers that were in malls." Established regional names like Miller's Furniture, David Weis and Philip Pelusi were among Giffin's clients in the 1980's and they did the construction for the Polo Store franchise that was owned by Oxford's Ed Lewis. The retail work took them out of town and on one of the projects Giffin hired a local superintendent that would impact the company significantly.

"I ran into [Gerry Gibson] while we were doing a Polo Store in Kentucky," says Giffin. "I think he ran the first job that made us money. He really knew how to manage a project. One day he called me and said he wanted to hire his son. I said no but the next time I saw him he had hired Monty."

Monty Gibson joined the company in 1991 and has since made a big impact on Giffin Interior. After working in the field Gibson moved into estimating and has been a fixture with Giffin ever since, now as vice president he is one of four managers who guide Giffin Interior & Fixture. Along with Gibson, Gordon and Dustin Giffin, Terry Walsh is a key manager running the operations side of the business.

A change in the retail market in the 1990's caused a change in direction for Giffin Interior. Their forte had been the inline retail store, usually owned by a closely held business. While the company had been responsible for a build-out for many spaces in a mall like South Hills Village over the years, the retailer mix had shifted almost entirely to national "A" credit tenants who used a stable of traveling contractors that worked all over the country. Moreover, the enclosed mall business model was growing stale and the trend was towards big box stores and retail centers. By the end of the 1990's Wal-Mart and Home Depot were "in" as retailers and Giffin decided they were out.

One logical strategy was to move completely into commercial interiors and millwork. While the clients would be different – Giffin was by now working mostly for general contractors – the kinds of spaces and scope of work wasn't going to be. The transition was not easy on his skilled workforce. "We had good finish carpenters but it's tough to adapt to custom casework and millwork," Giffin says. What enabled the transition was the fact that Gordon Giffin had been investing in his shop's technology.

The company's first shop had been a sublease from one of their material suppliers, Austin Hardwoods, from whom they took two-thirds of a building off Vanadium Road in 1981. Two years later they absorbed the rest of the building and then bought two adjacent buildings from the Waterson brothers in 1989 and 1994, finally doing a physical addition to the combined property in 2008. All that space was needed as the business volume grew but also because it was needed to house new technology in equipment.

"I got our first CNC [computer numerical control] router in the early 1990's," Giffin says. Since then the company has added production equipment that automates virtually every aspect of manufacturing and assembly of cabinets and millwork. Jobs are bar coded and the materials for each are collected, coded and processed together throughout. Computers analyze the material cutting to minimize waste. Skilled operators now oversee precise manufacturing of multiple steps at one workstation instead of individual steps in the process. "The equipment was needed to get more competitive and continue to grow. We get a lot of work done in a short time."

The investment in the operation attracted the attention of PCN TV, which filmed a video tour of the Giffin Interior extensive shop in 2007 (the video is still available at the PCN online store for $19.95).

Also in 2007, Gordon Giffin's son Dustin joined the company. Like his father, Dustin hadn't taken a direct route to the millwork business either. He went to college at Ohio State University but wasn't intent on a course of study. "I changed until I ran out of majors," he jokes. "I enjoyed politics so I settled on political science." After graduation, Dustin Giffin worked for a time for the Republican Party but was drawn back to the family business. It's not surprising that Dustin sees the business slightly differently from his father.

"To me it's about service. That's what we do," he explains. "The products speak for themselves but we're in the service business." Dustin looks beyond the industry for peers and benchmarks with which to manage the business. "We should model ourselves after the biggest and best businesses in the world but we still act like a small company."

Gordon Giffin jokes that the way of the next generation means that his hollering at his employees is no longer an accepted motivational tactic. Giffin had actually tried retirement early in the last decade but it didn't stick. Having his son involved in managing the company has given him renewed interest in the business but his tutelage has already taken root in Giffin Interiors.

"Gordon always said that you need diversification to survive and grow," says Monty Gibson. "We're diversified in both geography and the type of work we do." Gibson says that Giffin Interior & Fixture is able to compete on the west coast, in Las Vegas and in the big eastern U. S. cities, places where the skilled labor is valued similarly to the Pittsburgh market.

The perception of higher cost is something that Gordon Giffin says his company is used to managing. "Along the way we got a reputation for being the best, if you could afford us," he says. "We've always just asked for the chance. The way we work we can be as competitive as the others out there." BG

Selecting The Right Dispute Resolution Provision

By Jason Yarborough, Esq.

There are a number of terms negotiated in every construction contract. One of the most important and oftentimes overlooked provisions in a contract is the dispute resolution provision. It is not uncommon for an owner or contractor to try to use boilerplate contract terms from project to project. We counsel our clients to revisit the dispute resolution paragraph on each job to make sure that these terms are appropriate for the current project. Not only do these provisions typically set forth where a dispute will be heard, who will pay the costs for dispute resolution and whether or not a claim will be litigated in court or arbitration, dispute resolution provisions also address whether the parties must mediate their claims prior to filing suit.

Parties elect alternative dispute resolution provisions, or ADR, for a number of different reasons. The most frequently given reason by parties selecting ADR is the belief that it will be faster and less costly than litigation in court. This is not always the case. Sometimes ADR is more expensive than traditional litigation, especially when unlimited discovery is conducted.

Arbitration is one form of ADR. It is an alternative to having a case decided by a judge or jury. Instead, the parties typically select one or three arbitrators to decide their dispute, depending upon the amount in controversy. The rules for how arbitration proceeds will depend in large part on the parties and the arbitrators. There are a number of different forums to arbitrate construction claims, the most widely used being the American Arbitration Association ("AAA"), which has developed a comprehensive set of arbitration rules and mediation procedures, including procedures for large and complex construction disputes.

Arbitration has its advantages and disadvantages. One of the largest disadvantages are the costs associated with the arbitrator's services. Unlike a judge or a jury, arbitrators are paid by the parties for their services, typically at an hourly rate. Arbitrator fees can be significant over the course of the proceedings in larger cases. The parties usually split these costs unless the parties have otherwise agreed. Sometimes there are complex issues and a significant amount in controversy which warrant these costs. Oftentimes there are not. The ability to select a decision maker who is familiar with the industry or the relevant legal issues is a benefit to arbitration. This may help reduce the learning curve that would otherwise be necessary with a judge or jury unfamiliar with industry practices.

The arbitrators' fees are not the only costs parties should consider. Most arbitrating bodies, including the AAA, have filing fees that must be paid by the party initiating the claim. These fees can be significant. The AAA's filing fees for construction disputes range currently from approximately $1,000 to in excess of $18,000, depending on the size of the claim. The combination of arbitrator fees and filing costs make arbitration unsuitable for resolving many small monetary claims. Thus, the ADR evaluation process should include an assessment of the scope and size of the contract as well as the appropriate number of arbitrators.

The degree of finality is another distinguishing characteristic of arbitration. There are very limited circumstances under which a losing party can appeal an arbitrator's award. This increases the risk of being stuck with a bad ruling, as it will be unlikely that a litigant can correct any errors made by the arbitrator. A significant amount of power is vested with a single arbitrator. Obviously the arbitrators must

THE PARTIES USUALLY SPLIT THESE COSTS UNLESS THE PARTIES HAVE OTHERWISE AGREED.

be selected carefully and parties should consider the pros and cons to the finality of arbitration awards in determining if it is the best method to resolve potential claims on a project.

Mediation is another form of ADR which typically aims to resolve construction claims at a very early stage before significant legal costs are incurred. Mediation is less formal and more closely resembles a structured settlement conference. The goal with mediation is to help the parties come to a voluntary agreement on how they would like to resolve the dispute. Unlike a civil trial or arbitration, there is not a "winner" or a "loser". This is a very different dynamic than other forms of ADR, and can be quite useful in getting the parties to amicably resolve their differences.

As with arbitration, participants have an opportunity to select the mediator from a number of potential candidates. Mediators, like arbitrators, can be attorneys, engineers, architects or contractors with expertise in a particular area. The parties should carefully select the mediator based on his/her qualifications, professional experience, peer reviews and whether their particular style is well suited for the occasion.

Most mediation begins with each side presenting their case, some of the pertinent factual issues and the reasoning behind the positions they have taken in the dispute. Mediators typically ask the parties questions about these issues so that they can provide an opinion as to the strengths and weaknesses of the parties' respective positions, help facilitate settlement negotiations between the parties, and sometimes to suggest a resolution. During this process the mediator may challenge positions asserted, recast the issues raised in a different light, and try to get the parties to think about the financial, business and emotional impact of litigation, and not just a determination of who is right, and who is wrong. To be successful, all parties to the mediation process must come to the proceeding with a willingness to compromise and a sincere desire to settle their dispute.

Mediation participants should not treat the proceedings with any less care and preparation merely because they are less structured. It is critically important that parties participating in mediation be prepared to provide a detailed explanation of their claims, be able to explore the relevant documents and issues, and present their positions in a clear and convincing matter. If done incorrectly, you risk portraying your position in a negative light and may reinforce the notion in your opponent's mind that their valuation of the case is correct, not yours. While there are legal costs associated with preparing for and attending a mediation, there are substantial benefits in having a chance to deliver the appropriate message with a mediator to facilitate settlement and potentially save a party substantial additional legal and business opportunity costs that would be incurred in a trial or arbitration.

Parties may have difficulty in determining the amount of information and documentation they wish to exchange. On one hand, the parties need to have enough information to intelligently discuss the facts and issues and value potential claims. Participants are encouraged to exchange relevant materials necessary to support certain claims and defenses prior to the mediation. These exchanges are typically confidential and cannot be admitted in future legal proceedings. This free exchange of facts and ideas can help promote a resolution.

MEDIATION PARTICIPANTS SHOULD NOT TREAT THE PROCEEDINGS WITH ANY LESS CARE AND PREPARATION MERELY BECAUSE THEY ARE LESS STRUCTURED.

However, confidentiality does not ensure that such information cannot have negative repercussions. There is no requirement that the mediation results in a settlement. The mediator cannot force a result on the parties. Both sides are free to stop negotiating should they find the mediation unproductive. While it unlikely your opponent can use the actual statements and documents exchanged during mediation against you at trial, it nonetheless will be aware that they exist and may attempt to reestablish those facts through other methods in litigation.

The voluntary nature of mediation is another factor to consider in how effective it will be. If parties are required to attend mediation because of a contractual term or court order, but have no real interest in attempting to negotiate a resolution to the dispute, you may incur legal fees and costs preparing for the mediation, attending the mediation and compensating the mediator for his/her time without any meaningful results. If a party is only attending mediation because it is required to be there, it may attempt to use the mediation as a fact gathering exercise to prepare for the pending litigation instead of genuinely attempting to resolve the dispute.

In sum, alternative dispute resolution provisions can be beneficial in reducing litigation costs and expediting a resolution of claims. Sometimes it has the opposite effect. Review your dispute resolution provision carefully when negotiating your next contract and consider whether or not an ADR provision makes sense for the size and scope of the project.

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Surety Market Update

"I think if you have what I said last year, you can use it again," jokes Jim Bly, managing director and surety practice leader for broker Marsh USA in Pittsburgh.

While Bly jokes about how similar the outlook for 2012 is to last year, he and other experts are quick to point out that the insurance industry in general, and surety specifically are drifting towards what the business calls a 'hard' market. Such market conditions represent the insurance industry's reaction to a perceived risk of higher losses, either due to catastrophe or bad business. Hard markets are characterized by less capacity, higher premiums and tighter restrictions on the insured, in this case the contracting community. Insurers say that the market isn't there yet but they don't see conditions softening in the near future.

The surety industry as a whole is not necessarily in bad shape. Unlike the last business cycle, the recent recession caused some increase in losses but over the course of the last five years the losses were actually lower than in several of the boom years. As an industry, sureties took in almost $5.2 billion in direct premiums in 2011, a volume that was roughly the average of the premiums from 2006 through 2008 and double the premiums of the trough of the recession in 2009. But the overall industry numbers mask the problems that loom from top to bottom because the biggest insurers have done exceptionally well.

"The top ten insurers – their market share is 57.5 percent – all have pretty clean loss ratios right now," notes Jay Black, managing partner of the surety division for agent Seubert & Associates. "All had direct loss ratios under 20 percent. With overhead figured in they have combined loss ratios of 75 to 80 percent, which is a pretty good place to be."

"The top ten sureties did very well again in 2011 but if you look at 11 through 30 the results reflected higher loss activity," says Bly. "Nationally we're getting word of more [project] failures. Losses will start to mount if that continues so we'll reduce capacity or rating. It feels like the industry is moving slowly towards a hard market."

John Nissley, executive vice president for Willis agrees with the direction that his counterparts have expressed but sees the health of the industry as a mitigating factor. "It's tough to nail down now. I have heard lots of experts predict conditions during the last two years and none of them have been correct," he maintains. "No one is saying things are just humming along but it could be worse."

What concerns virtually everyone in the insurance industry at this point is the effect of the prolonged slowdown that began with the financial crisis in late 2008. Midway through the fourth building season since the crisis, competition is still very tough; margins are tight; and the amount of work available is still insufficient for contractors and subcontractors to get consistently profitable. In a normal business cycle, the third year after a recession is the first real year of recovery and the conditions often expose those who took bad work when the market rebounds. That year, which would have been 2011 in this cycle, is typically when the bulk of the business failures occur. For a number of reasons the problems seem to have been pushed off into this year.

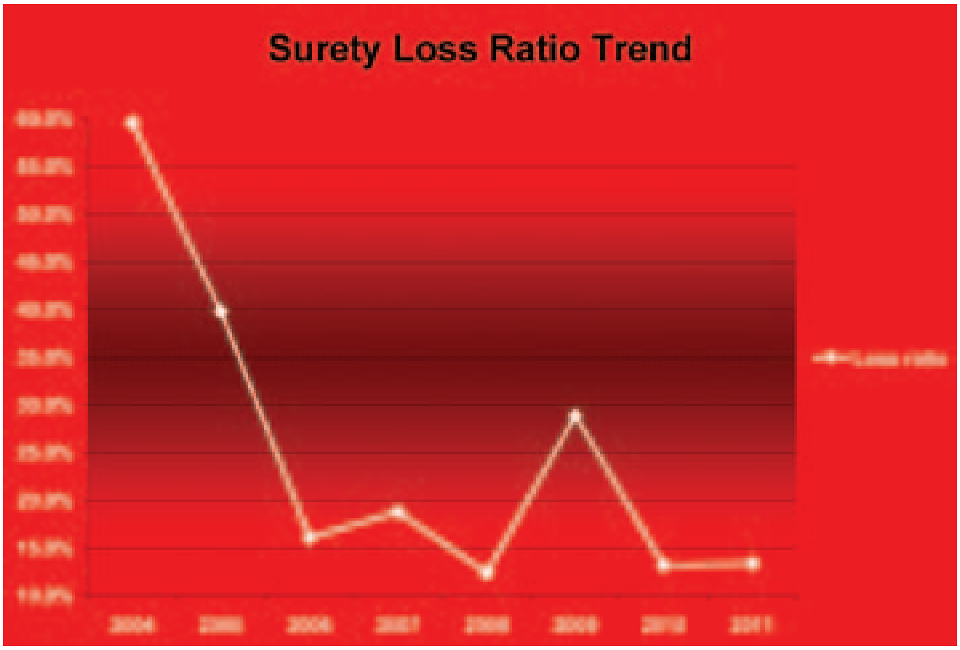
"I'd say more contractors lost money in 2011 than in 2010," says Black. "I'm not saying they are going out of business or causing surety losses but simply that more didn't make money last year. With the times, contractors have been more disciplined about keeping their 'A' players and they have been able to hang in there."

Bly's estimate is that six out of ten general contractors who relied on Southwestern PA for revenue lost money in 2011.

Accountant Mark Bronder, partner at KFMR agrees that the past year has been difficult for construction companies and that the likelihood is lower bonding capacity and higher rates are coming. Even with the tougher conditions, Bronder points out that businesses aren't leaving the industry voluntarily.

"The staying power of small business in this industry is unbelievable," he says. "I have sat with clients over the years and recommended they do bankruptcy after reviewing their financials but they manage to string out payables and make ends meet until things get better. I remember one client who had a big receivable that had to be written off that he wanted to keep on the books. Three years later he called to tell me he had been paid it in full."

Whether it is doggedly pursuing receivables or cutting costs to the bone, contractors have been in a survival mode and seem prepared to remain diligent through 2012. But the concern about when the market will improve is fairly universal and with each month that passes in 2012, contractors are less convinced that they can pin their hopes on 2013. Even if the election is the pinch point that releases a flood of pent up projects, the cutting could produce problems as more work becomes available. Contractors may not be able to build capacity as quickly as they secure work, which could create problems from the inability to manage the projects as profitably.



"Subcontractors have been holding on better than in past slowdowns, but if the growth in the economy does occur we'll find out how well the subs are positioned to grow," reports Nissley. "Growth is great but it can be a bad thing if you're not prepared with staff and capacity."

Getting to the next growth cycle would seem to be more of an issue in 2012 than worrying about adequate staffing and project management. If the insurance industry is going to tighten its underwriting for surety bonds the impact will be felt throughout the industry. Project owners can't take for granted that the contractors selected for the job will have the bonding required and relaxing bonding requirements isn't advisable. For the construction companies, tighter standards mean that their financial results will be more important in 2012 and their reporting will increase. More frequent reporting is probably unavoidable for contractors and it's something that should be embraced, suggests Gennaro DiBello of Schneider Downs & Co.

"I encourage clients to communicate issues with their surety early and often but also to present their financial data in the most accurate way to the readers of the reports," DiBello says. "We would advise clients to enhance their balance sheets within the limits of their business. Is there excess inventory that can be sold? What is the frequency of distributions to principals? There can be hidden value in the balance sheet. For example, a heavy and highway contractor may have equipment that is fully depreciated but that yellow iron has value."

The readers that DiBello refers to are the surety company underwriters and agents. What they will be looking for is the financial strength of the contractors and the profitability of the company's work in progress. The balance sheet represents the underlying strength of the company, its ability to weather a tough market because of cash, hard assets and low debt. Even in a tight market the contractor's work can also be profitable. The more frequent financial reviews will focus on the contractor's plan for profitability on each project and how that plan improves or erodes as the work progresses. Projects for which profits are slim can make a surety nervous but not as nervous as profitable projects that become unprofitable as they proceed.

The plan is critical to the evaluation of a company's surety status, says Mark Bronder. His opinion is that markets like this can't be avoided and it is the management of a tough situation that separates good companies from bad.

"We'd recommend three things," he explains. "If you are having a bad year keep the surety in the loop. They hate surprises. Second, be timely in reporting. I'm meeting more often with clients because they have to meet more often with the surety. Finally, have a game plan. We want to sit down with the client and the surety to say here's where we are and here's how we are going to get through it."

Of course no plan would be as effective a solution as getting more business. That goal can often add to the problems, if the work taken has poor profit potential but an overall increase in the volume of work available would go a long way towards heading off a hard surety market and another less profitable year for the construction industry. There are enough owners and developers who have the demand and need for new construction in 2012, but the trick will be getting them to pull the trigger. To John Nissley, that's a scenario that is better than any financial or underwriting solution.

"One thing I hope happens is to see more certainty in the market from owners who will feel confident about proceeding with projects," he says. "If business owners can have certainty about how they will run their businesses it will really help the construction industry."

Uncertainty about future conditions seems to be the biggest factor constraining new construction, however, and there seems to be little that will assuage that until after the elections. Unless contracting picks up significantly there is less uncertainty about what the construction industry can expect from insurers in the coming year or so.

"In the last hard market in 2004, 60 percent of the contractors had a change to their surety program," reminds Jim Bly. "That means decreased [bonding] capacity, an unfavorable change in rating, bonding of subcontractors or owners having to put more cash in the business." BG

Management Perspective

Navigating the Seller's Market in Commercial Real Estate

A combination of improved employment, hot industries and limited new construction have created market conditions for offices, industrial, apartments, hotels and even retail that are a landlord's dream in Metropolitan Pittsburgh. In an extended sluggish national economic environment there are few markets that could be considered a seller's market, but Pittsburgh is certainly one.

The problem is a very simple one: there is insufficient supply to meet the demand for space. While this is the stuff of the first week of Econ 101, how the supply/demand imbalance resulted was a mix of good and bad fortune.

On the good side, the occupancy levels of the metropolitan area and its sub-markets have been climbing for the better part of the decade and remained virtually intact throughout the 2008-2009 recession. It isn't that businesses didn't downsize or experience difficulties during the recession but the ones that were surviving or prospering even through the downturn continued to require more space. And as the regional economy has experienced growth again over the past 18 months, many of the region's growing companies were looking for even more.

Several of the biggest milestones during this steady decline in vacant space have been well-documented. The Westinghouse corporate headquarters development in Cranberry Woods and UPMC's consolidation of administrative space into the USSteel Tower, were two high-profile examples that resulted in nearly two million square feet of occupancy. Less well documented, however, is the fact that neither of these two relocations left holes in the sub-markets that were vacated. UPMC continues to bring people into Downtown while Oakland remains a market with almost no vacancy. The Westinghouse move from Monroeville left a potential void but as the last of the employees are moved to Cranberry this summer, Monroeville has higher office occupancy than when Westinghouse was fully operating there.

Much of what has created the tight market for space can be attributed to good economic fortune. Strong institutions for higher education and healthcare ensure that Oakland is fully occupied. Pittsburgh companies involved in energy have added thousands of jobs. And the natural gas business began ramping up its administration and engineering hiring as the recession kicked in. Unlike most U. S. cities, Pittsburgh has had emerging industries at a time when established industries were scaling back.

The other major contributing factor to the supply and demand imbalance has been the inability of commercial real estate developers to get projects financed since the mortgage crisis. In almost every way this is of course, a bad thing. By limiting financing to build-to-suit projects only, the lenders made it impossible for developers who perceived needs to forge ahead with projects without putting disproportionate levels of equity in the project. A few projects with space to rent did go ahead but many more projects did not make sense under the lending conditions that have existed from 2008 until even today.

For two of the major commercial categories, hotels and apartments, the financing issue has not been an issue for more than two years, in part because of the unusual demand and in part because there were large financial institutions virtually throwing money at these two categories regardless of the region.

Hotels and motels owe their market conditions almost entirely to the explosive growth of the natural gas business between 2009 and 2011. Along the I-79 corridor a number of hotels/motels have been developed in the past few years and more are in the pipeline, particularly in the Bridgeville-to-Washington section. Since January 2011, construction has started on more than 1,300 rooms in 13 different hotels. Yet according to Smith Travel Research the occupancy rate in Pittsburgh's hotels last year reached 68.2 percent, well over the national average of 60 percent. Revenue per average room also reached record levels. High occupancy and high room rates are convincing factors for lenders, especially when even the national news is peppered with stories of drillers sleeping four or six to a room because of a shortage.

Apartments have benefitted to a large degree from the housing crisis, as the number of renters grew due to tighter financing or reluctance to buy. Apartment vacancy rates in Pittsburgh are extremely low, somewhere between 2.5 and 3.8 percent, depending on the information source. With the highest occupancy in the country, Pittsburgh apartment owners were able to raise rents by an average of 6.8 percent in 2011. Again, these numbers are music to a lender's ears.

Perhaps it is because of the abnormal circumstances that created the short supply of space, however, that the conditions aren't likely to change any time soon for the office and industrial property types.

It seems likely that the positive occupancy trends will continue in the Pittsburgh market, even if hiring slows on a national scale. Most of the biggest occupants in the office market are healthy and growing. A fair number of big users remain in the hunt for space, mostly for new or expanded facilities. Among them is USSteel, which could potentially leave the region or take significantly less space than they occupy in Downtown now, but most observers feel that the vacant space in USSteel Tower would create more opportunity for UPMC to grow.

Likewise, significantly more space is being sought by industrial users than is available or under construction to deliver into the market the remainder of the year. Industrial developers have been limited to build-to-suit opportunities since the financial crisis and there have actually been quite a number of new facilities built. In particular, the I-70 corridor has been a fertile location for the 20,000 square foot to 70,000 square foot users that make up the natural gas supply chain and have filled underused parks like Alta Vista or I-70 Industrial Park near Scottdale. Developers with good industrial track records have projects in the pipeline but absent a build-to-suit or major tenant opportunity there will be little speculative industrial space added to the inventory in 2012.

For users, especially office users in the heavily-occupied Oakland and downtown markets the short supply has made decisions about leasing simpler, if less exciting. During the past year or so a number of office users came upon lease expirations that turned into very short one-sided negotiations. Some of these users, like law firms McGuire Woods and Dickey McCamey Chilcote had signed in their buildings during the middle of the last decade and got competitive rents and attractive tenant improvement allowances. In 2011, there was little else available for companies needing big contiguous spaces to entice a tenant away from a building and so few incentives from building owners to offer much but a rent increase.

According to information submitted by CBRE, Grant Street Associates, Jones Lang LaSalle and Newmark Grubb to the Downtown Pittsburgh Partnership's 2012 Annual Report, only one of the leases over 100,000 square feet in 2011 were new. Even that lease, the 267,500 square foot expansion by UPMC in the USSteel Tower, involved a company that remained in the building. The other big leases – Highmark, ServiceLink, Federated Investors and Dickie McCamey – were all renewals.

In past cycles a half dozen or so leases expiring that were over 100,000 square feet would mean a handful of significant tenant improvement projects. In fact, just prior to the recession there were roughly that many high-profile projects involving law firms alone. Projects to fit out new space for Reed Smith, K & L Gates, Jones Day and Cohen & Grigsby varied in size from $7 million to almost $40 million. Those opportunities didn't exist last year. With Millcraft's Gardens project moving towards a start this year it is a good bet that at least one big user will find that new building enticing enough to move, but at least one big user – GNC – opted to buy their building rather than move as a tenant to another.

While these dynamics are pretty good for building owners, a number of players in the market would prefer to see more inventory and choice.

"Well in the near term there's not much you can do. Product doesn't just fall out of the sky," laughs Brad Totten, senior vice president at Avison Young. Totten is a commercial broker who represents tenants. The seller's market makes it tougher for Totten because the shortage of options means his clients don't get the service he would like to provide, but he says that just changes how he counsels them. "Our clients need help now more than ever. And we have to be creative in adding value to the relationship. For example, a client may have a lease that expires in three years in a building that has a mortgage that's up in two. If we can get them into a longer term lease and fix the rate they are in a better position for the future."

Interior designer Mary Ann Mozelewski of m/Design has historically made a fair share of her living by designing new spaces for office clients. Without the new space available, her services are limited as well.

"It's not just big companies. The mid-size companies would normally have picked up new space to do something fresh to help with recruiting and retention and all those things they talk about," she says. "Right now those opportunities don't exist."

With rents drifting into the upper $20 per square foot range on Class A space and precious little inventory the Class B rents are being pulled higher, moving from an average of $19.50 to around $21 per square foot. The rent action should be making the case for buying a B building and renovating but the best candidates for those kinds of projects have already been snatched up and are being earmarked for re-purposing. Developers' plans for the Oliver Building, the Reed Building and the former Alcoa headquarters involve apartments with a mix of hotel and some office space. The best bet for a significant B building project is the Union Trust Building, however the ownership issues of that property – now branded as 501 Grant Street – still need to be resolved before any further space can be prepared.

Without the land constraints of the Golden Triangle, the suburban markets offer a more immediate solution to the inventory problem, at least once the financing picture clears up more. Developers have been buying land and talking about projects in the Cranberry and Parkway West markets. In Cranberry nearly two million square feet are proposed but only about one-quarter of that has been entitled. A smaller number of projects have been identified in the airport corridor but with the focus of the natural gas business shifting to the Utica Shale formation, more projects are expected.

Still, the best case scenario for all of this space pushes any significant deliveries to inventory out until 2014 or 2015. In the central business district the timeline is roughly the same. In the meantime, brokers and tenants will have to make the best of the market's limitations and look hard for options.

"Tenants have to pay $35 to $38 per square foot to justify new construction right now," says Totten. "Barring a big layoff – and nothing good comes of that for the economy – there will be limited opportunities." BG

Best Practice

Total Cost of Ownership in Commercial Real Estate

By Michael Cahn
Vice President, CBRE, Inc.

Introduction

The decision to develop, purchase or occupy a building is driven by a number of factors. Why an owner or developer ultimately selects a particular property can be determined by factors that are rooted in current market conditions or more immediate needs of a business that could change within a few years. It is not uncommon for a buying decision to be built upon a set of assumptions that each party knows will not be true indefinitely – and which would dictate a different choice if circumstances were to change.

More often than not, however, the decision-making process in a real estate transaction could be improved by taking a disciplined, systematic approach to evaluation that leads to an understanding of the Total Cost of Ownership (TCO) of any property being considered.

TCO is a pragmatic tool that occupiers can use to determine their true cost of making facility decisions. It includes the total cost of designing, constructing, operating and maintaining a project over its anticipated lifespan. TCO can also integrate the cost and benefits associated with productivity, sustainability, and risk.

Total Cost of Ownership has been around since the late 18th century. The Gartner Group resurrected TCO in the 1980s for measuring the total costs of evaluating, deploying, and operating large IT systems. TCO analysis is applied across a wide range of decisions: the US Coast Guard applies TCO to "more effectively and efficiently manage its capital assets" (bases, helicopters, ships, etc) and Edmunds.com developed a TCO tool to reveal "the hidden costs -- all the costs -- associated with buying, owning and operating a car over a five-year-period."

TCO's value resides in its whole-system's approach to calculating the cost of complex purchases. When properly applied, TCO is particularly effective in commercial real estate to normalize costs between properties and across transactional structures.

Calculating TCO

Total Cost of Ownership is determined by adding the direct costs and (relevant) indirect costs of owning and operating asset over its lifespan, or TCO = Direct Costs + Indirect Costs. For commercial real estate, the following formula provides meaningful structure and facilitates comparative analysis:

TCO = npv ((AC + O&M + DC) + IC))

npv = net present value

AC = Acquisition Costs

O&M = Operating & Maintenance Costs

DC = Disposition Costs

IC = Indirect Costs

Let's apply this formula to "XYZ Corp." that is considering relocating to a new $8.0 million corporate headquarters. At a simplistic level, XYZ may rely solely on the $8.0 million price tag to support its buying decision; however, acquisition price alone is an incomplete picture of the total costs.

Through its systematic approach, TCO delivers a comprehensive insight into a property's costs and benefits over its lifespan as follows:

AC = Acquisition Cost

In real estate terms, the "project costs" or "lease rate" (the $8.0 million XYZ is spending to develop its new headquarters). For naïve buyers, this could be the only financial basis for making their buying decision; it ignores other direct and indirect cost of owning, occupying and disposing of facilities.

O&M = Operating & Maintenance Costs

Whether you acquire by purchase or lease, buildings cost money to operate. O&M includes the traditional operating costs: real estate taxes, insurance, utilities, and management. TCO also incorporates the ongoing capital costs: roof, parking lot, base building renovations, tenant improvements, and furniture, fixtures and equipment (FF&E).

Combining the operating and capital costs produces the truest cost of running the property over time. As Gartner discovered with IT systems, the O&M costs can easily eclipse Acquisition Cost over a property's lifespan. For XYZ, their upfront choices on design and building systems can dramatically affect when the operating and maintenance costs surpass its acquisition cost.

For example, assume that XYZ Corp. selected its $8 million property over a building with a similar location and size but with a higher price because of its brick (not EFIS) construction. XYZ would be well-advised to consider the additional O&M costs (as well as the impact on disposition value or financing) involved during the lifecycle of its occupancy of the building compared to the brick option.

DC = Disposition Costs

How much will it cost to dispose of the facility at the end of its lease or lifecycle? For a lease, DC can be an early lease buy-out or restoring the facility to its original condition. For ownership, DC could be the cost of selling or decommissioning the building according to environmental regulations.

Disposal Costs can often result in a financial gain, arising from the net proceeds of the sale at the end of the lifecycle. In that case, the Disposal Costs would reduce TCO.

IC = Indirect Costs

Indirect Costs are the relevant costs that vary between opportunities or transaction structures that are being evaluated. IC could consider the cost of change or disruption as a result of moving to a new facility. It can also integrate the benefits associated with productivity, operational benefits, and flexibility of a specific property, or transaction structure. In XYZ's case, the disruption cost to its business by renovating and restacking its existing facility may far outweigh its Direct Cost savings of staying put.

TCO's integrated approach puts rigor to commercial real estate decision-making. Its structured approach normalizes alternatives and helps occupiers appreciate the impact each choice has on the "whole-system".

How Can Occupiers Use TCO?

Occupiers can use TCO to identify their real cost of acquiring, operating and exiting facilities. TCO's methodical approach helps occupiers incrementally build up their lifecycle cost for each alternative. These costs produce a projected stream of cash flows which can be discounted to present value using the occupier's cost of capital.

Applying TCO to each option and structure produces a normalized picture of the costs and benefits of each choice. Incorporating Direct and Indirect Costs empowers occupiers with considerably more insight; it provides occupiers with an integrated appreciation of how each option supports their operating business over the property's lifespan.

How Can Developers Use TCO?

In the hands of a high-performance developer, TCO is a powerful tool for educating the occupier on the whole-system economies. The developer can use the tool to help occupiers produce their ideal TCO. The high-performance developer can help the occupier reduce his total cost by positioning the location and design of the property to maximize its desirability to subsequent users, and minimize Disposal Cost.

By applying TCO, the high-performance developer can produce a facility that is more than bricks and mortar and initial price. Additional value can be captured on the low end by easing the occupier's selection process, or be as complex as designing a facility that reduces the occupier's employee turnover.

Conclusion

Total Cost of Ownership is a powerful tool for commercial real estate. TCO provides a methodical approach for evaluating complex, interrelated elements. These elements, in proper tension, form the backbone for producing outstanding facilities: facilities that are uniquely configured to achieve an occupier's desired level of quality, cost, and sustainability.

And, in the right hands, TCO helps the high-performance developer be a collaborative partner whose value and contributions can be tangibly measured.

Sources

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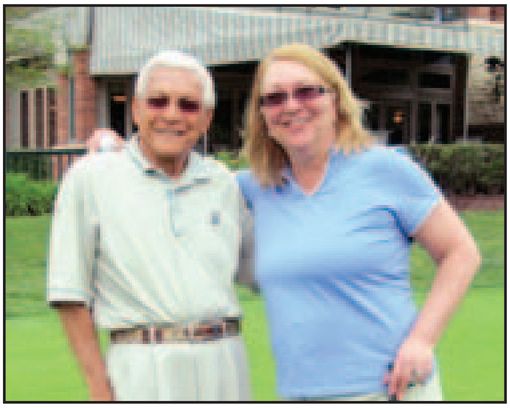
INDUSTRY & COMMUNITY NEWS

MBA Launches Industry-Wide Green Builders Committee

The Master Builders' Association is pleased to announce the launching of the MBA Green Builders Committee. The mission of this committee is to improve our region's construction community by uniting, promoting and creating a pool of professionals that facilitate healthy, sustainable living while building our region.

The committee consists of: Michael Kuhn, Chairman, Jendoco Construction Corporation; Phil Linton, PJ Dick Incorporated; Adam Ramsey, Wyatt Incorporated; Scott Rowland, Langan Engineering & Environmental Services; Michael Tarle, Massaro Corporation; John West, Mascaro Construction Company, L.P.

The newly assembled committee will carry out their mission by placing a strong emphasis on education, as well as promoting the efforts of the Green Building Alliance.



John Ghaznavi of Ghaznavi Investments, Inc. with CREW past president Cindy Kamin from CBRE at the CREW golf outing at Southpointe.

(left-to-right) Bret Kresak from FedEx, Natalie Abel and Mike Behr of Energy Savers Inc. and Paul Kitt of P&P Custom Medical Supplies at the CREW outing.

March of Dimes Honors Local Projects and Labor

The March of Dimes held its annual Transportation Building & Construction Awards luncheon on June 19, which raised over $125,000 to support the lifesaving research and educational programs aimed at giving every baby a healthy start in life. Honorees included PennDOT Secretary Barry Schoch, Richard Stanizzo, Jr., Business Manager of the Pittsburgh Regional Building and Construction Trades Council, who was honored as 2012 Labor Leader of the Year. The Awards also honored the North Shore Connector, built by Trumbull Corp./Obayashi and the Gates/Hillman Center at Carnegie Mellon, built by PJ Dick Inc.

KDKA's Rick Dayton with CMU assistant provost Ralph Horgan at the March of Dimes Transportation Building & Construction Awards. Photo by Archie Carpenter.

Rick Dayton and Rich Stanizzo. Photo by Archie Carpenter.

Mascaro Sponsors 20th Rebuilding Together Home

Mascaro Construction sponsored its 20th house this year for Rebuilding Together Pittsburgh. The home was located near Mascaro's headquarters in Manchester. Mascaro employees spent the day painting, landscaping, and cleaning. Mascaro was also a main sponsor for the Great Strides NorthShore Walk on May 3, 2012. The event raised over $44,000 for Cystic Fibrosis.

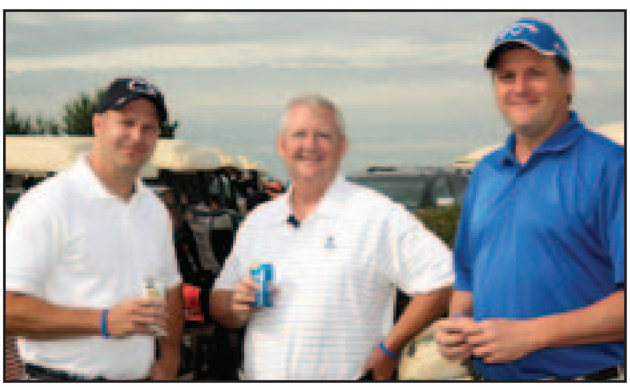
The Mascaro Construction team at the 2012 RTP Day.

Members of the winning team at the MBA's Young Constructors golf outing included (left-to-right) Seubert's Brian Hartman, Damon Thomas from Blumling & Gusky and Nello's Gino Torriero.

Jeremy Waldrup, President and Chief Executive Officer of Pittsburgh Downtown Partnership; Barbara A. McNees, President of the Greater Pittsburgh Chamber of Commerce; Allegheny County Executive Rich Fitzgerald; Steve J. Guy, Oxford President and Chief Executive Officer; and Louis G. DiNardo, Oxford Chief Operating Officer and Pittsburgh Mayor, Luke Ravenstahl. Photo by Mark Grasso, Oxford Development Co.

The MBA's Jack Ramage with speakers Ken Simonson, chief economist for the AGC (left) and Steve Forde of the Marcellus Shale Coalition (right) at the MBA's spring economic review.

(left-to-right) Jendoco's John Zang, Chris Haupt from D. L. Astorino, Stephen Good of P.C. McKenzie Corp. and John Oxenreiter of McClure-Johnston Co.



Joe Johns of Henderson Brothers (left) with the MBA's Bob McCall and Greg Latsko of Mobile Medical at the D. R. Papalia Memorial Golf Outing on June 11. Photo by M. Philip Sam Photography.

(From left) John Huss and Bryan Wallace from Blue Mountain/ United Rental with Don Madeja & Nate Martin from outing sponsor Mascaro Construction. Photo by M. Philip Sam Photography.

Awards & Contracts

University of Pittsburgh selected TEDCO Construction as contractor on the Tosatto Pedestrian Bridge project at its Greensburg campus. Gateway Engineers designed the project. TEDCO is also doing renovations to McKenna Hall at the Greensburg campus. The architect is FortyEighty Architecture.

TEDCO Construction was awarded a contract for the buildout of ADP's tenant space by GlaxoSmithkline Beecham in Kennedy Township. Space Design Inc. is the architect for the project.

TEDCO Construction was awarded a contract to renovate 18,500 square feet for HDH Insurance on the 30th floor of the K & L Gates Center. Next Architecture is the architect on the project.

Uhl Construction was awarded a design/build contract for the Alstom Grid Facility Expansion in Charleroi, PA, a 23,000 sq. ft. Varco Pruden metal building addition that houses a shipping warehouse, offices, and testing areas. Stantec is the architect.

Baierl Cadillac in McCandless selected Uhl Construction as contractor for its $2 million renovation and expansion. The project was designed by RSSC Architecture.

UPMC Health Systems awarded a contract to Mascaro for renovation of the 12th Floor Clinic and Office Fitout project. The Design Alliance is the architect. Mascaro is the construction manager overseeing the west roof repairs at Heinz Hall.

The Senator John Heinz History Center awarded a contract to Mascaro Construction for the renovation of the former American Equipment Co. warehouse on Penn Avenue in the Strip District. The project will create 45,000 square feet of climate-controlled storage for the History Center. The Design Alliance is the architect.

Mascaro is providing preconstruction services to the University of Pittsburgh for renovations to the Oakland Campus Book Center. Architect for the project is Lami Grubb Architects.

The Pittsburgh Parking Authority awarded a $759,000 contract to Carl Walker Construction for repairs to the Smithfield/Liberty Garage in downtown Pittsburgh.

Carl Walker Construction is the successful contractor for renovation of the Nittany Parking Deck at Penn State's University Park campus in State College. Stahl Sheaffer Engineering is the project's designer.

First National Bank selected Dick Building Co. as contractor for renovations to its Fox Chapel Plaza branch in O'Hara Township. Harry Levine is the architect.

Rycon Construction, Inc. was awarded a contract to renovate two floors within One PPG Place for Towers Watson. This project is scheduled for completion by the end of 2012.

Rycon is responsible for renovating the former Roomful Express store on McKnight Road into a new location for Valu-King. This $2.3 million project started in June.

A 15,000 sq. ft. renovation of Party City in Monroeville is underway by Rycon's Special Projects Group. The $670,000 project is scheduled for completion mid-summer.

Rycon is the contractor for two new First Niagara Banks in North Huntingdon and Wexford in Pine Township. Designed by DLA + Architectural & Interior Design, both of these projects are scheduled for completion before 2013.

PNC Bank recently awarded Rycon's Special Projects Group a contract to build a 600 sq. ft. bank within UPMC Passavant Hospital in the North Hills.

On Walnut Street in Pittsburgh's Shadyside neighborhood, Dick's Sporting Goods is adding True Runner, a 4,000 sq. ft. store, which is being constructed by Rycon's Special Projects Group. The $400,000 project is scheduled for completion mid-summer.

Rycon Special Projects Group was awarded a contract to renovate 16 J.C. Penney stores throughout PA, NY & OH.

At Indiana University of Pennsylvania, the University of Chicago and Bradley University, Rycon Special Projects Group is completing various dining hall renovations which are scheduled to be finished before the start of the fall semester.

Landau Building Company recently completed a five room renovation for HOA/Physical Medicine and Rehabilitation at UMPC Mercy. The project began in February 2012.

Landau Building Company was recently contracted by Medrad to renovate two clean rooms. The projects are located in Medrad's Saxonburg and the Indianola facilities. The two thousand square foot renovations will happen concurrently and construction will take one week to complete.

Landau Building Company is renovating the Cardiology Department and Stress Laboratory at UPMC Mercy. The project began in April of this year and is anticipated to be complete in September.

Landau Building Company continues to assist MedExpress with expansion plans. Upcoming projects include a Wilmington, DE location and a new stand-alone MedExpress facility in Roanoke, VA.

PJ Dick Inc. is the successful contractor for the new Avonworth Primary Center, an 84,970 square foot elementary school for Avonworth School District in Ohio Township. The architect for the new school is HHSDR Architects & Engineers.

Massaro Corporation has been selected to serve as the general contractor for the upcoming renovation project at Oakland Catholic High School. The major interior renovation will provide new working space for classrooms, faculty space, storage and upgraded restrooms. Glance + Associates is the architect on the project. The seven month schedule will be completed in January 2013.

Massaro Corporation is the low bidder at Franciscan University of Steubenville for the renovation and addition project to Antonian Hall, the student dining hall on campus. This fast-track project will be completed by the start of the fall 2012 semester. MacLachlan Cornelius & Filoni is the architect on the project.

Massaro Corporation has been selected to serve as the Construction Manager at Risk for the upcoming New Patient Family Resource Pavilion at UPMC St. Margaret. The 9,600 square foot addition will house parking, a library, café and electronic resource center. The project has a 10 month schedule and is slated to begin in Summer 2012. Stantec Architecture Inc. is the designer on the project.

Penn Hills School District awarded Massaro Corporation the general trades contract for the construction of their new elementary school. The 172,000 square foot new school is slated to begin in summer 2012 and has a 21 month schedule. Architectural Innovations is serving as the Architect for the project.

Massaro Corporation has been selected by the Hill House Economic Development to serve as the general contractor for the upcoming Shop n' Save grocery store in the Hill

District. The 29,500 square foot building will house the grocery store along with other retailers. Renaissance 3 Architects and RSP Architects, LTD are the local and national architects, respectively, serving on the project.

Massaro Corporation is the successful contractor for the Preston South Area Pre K-8 School in Tunnelton WV. This 80,696 square foot one and two story masonry building is slated to begin construction in September of 2012 and will be completed in the spring of 2014. Williamson Shriver Architects is serving as the designer on the project.

dck worldwide's joint venture partnership with Environmental Chemical Corporation, dck-ecc pacific guam, LLC (dck-ecc), has been awarded a $46.6 million design-build contract by the Naval Facilities Engineering Command (NAVFAC) Hawaii for a fixed-price task order under a previously awarded multiple award construction contract for constructing an operations complex with an aircraft fire and rescue station at Marine Corps Base Hawaii (MCBH), Kaneohe.

Oakview dck, a dck worldwide company, has been awarded the $12.5 million contract to build Woodland Hills Elementary School, a 98,515 square foot school located in the Waukee School District on the west side of Des Moines, Iowa.

Volpatt Construction was the successful contractor on renovations to the University of Pittsburgh's Book Depository on Thomas Boulevard in Homewood. The architect for the project is Celli-Flynn Brennan Architects.

St. Clair Hospital awarded a $1.3 million contract to Volpatt Construction for construction of a Breast Center at their Oxford Square outpatient center in Bethel Park, PA. IKM Inc. is the architect for the project. BG

Faces & New Places

Burchick Construction Company is pleased to announce that Robert "Bubby" Mroskey has joined the Burchick team as a Project Engineer. Bubby is a recent graduate of the Penn State Architectural Engineering program, specializing in Construction Management. He has been a summer intern with Burchick since 2006 and has also obtained his LEED Green Associate certification. Bubby will be supporting both the estimating and operations departments at Burchick in his new position.

Landau Building Company is pleased to announce that Michael Bartoldi has joined the company as a Project Engineer. Michael is a recent graduate of Pennsylvania State University with a Bachelor of Science in Structural Design and Construction Engineering Technology with a concentration in construction management.

Landau Building Company is proud to announce that Mark Johnson, a project engineer with the company, has recently received The Associated General Contractors of America's Certificate of Management - Building Information Modeling (CM-BIM).

Rycon Construction, Inc. is pleased to welcome Tim Palmer as Project Engineer. Tim received a B.S. in Construction Technology & Management and an A.A. in Building Construction Technology from Pennsylvania College of Technology. He brings 4 years of construction industry experience to Rycon's team.

Rob Bishop joins Rycon Special Projects Group as a Senior Project Manager. Rob received a MBA from the State University of New York at Buffalo as well as a B.S. in Business Management. He has over 25 years of construction industry experience and will be heading up Rycon's work in the Western New York area.

Santino Angelo has been hired by Rycon as a Senior Project Manager in the Special Projects Group. Santino attended Penn State University and has more than 28 years of experience working in the construction industry.

Rycon Special Projects Group has also added Katie Nolan as an Estimating Assistant. Katie recently graduated from the University of Pittsburgh with a Bachelor's Degree in International Relations.

Megan Barry joined Rycon's Special Projects Group as an Administrative Assistant. She brings three years of construction industry experience to the Rycon team.

dck worldwide is pleased to announce the promotion of Kevin Rihn to Assistant Controller – Cost Accounting. Mr. Rihn is now responsible for cost accounting companywide and has worked in dck's Cost, Treasury, and Finance departments since 1997.

dck worldwide welcomes Eugene V. Bucci, Jr. as a Project Manager for dck's Pittsburgh area projects. Mr. Bucci has more than 27 years in the construction industry. In addition to project management, estimating, sourcing, purchasing, and project coordination, other areas of Mr. Bucci's expertise include design-build projects and pre-construction services.

Along with moving its headquarters to One PPG Place in downtown Pittsburgh, dck worldwide has opened up its new Shop, Warehouse, & Yard in Carnegie at 785 Arch Street, Ste. 200, Carnegie, PA 15106.

The Master Builders' Association Board of Directors are pleased to announce the appointment of James Frantz to the position of Chairman of the

MBA Education Committee. Mr. Frantz is President of TEDCO Construction Corporation, a commercial construction company based in Carnegie, PA.

Joel Bernard, AIA, has been appointed to the position of Co-Chairman for the AIA-MBA Joint Committee. Mr. Bernard is a Principal at IKM Incorporated. Chartered in 1965, the AIA-MBA Joint Committee consist of architects and general contractors, providing a unique forum that promotes the exchange of ideas between architects, contractors and owners.

After 35 years in geotechnical contracting, Andrew Walker, president of Nicholson Construction has announced his intention to retire. Mr. Walker started his career with the company as a Senior Project Manager in 1994. As planned, Christopher Hynes, current executive vice president will succeed Walker as president in late summer.

Lampus Company, a leading manufacturer and distributor of hardscaping, landscaping, concrete masonry products, silicon carbide and ferro alloys based in Springdale, PA, recently announced that Joe Vansovich has been named Corporate Controller. Joe is a graduate of Grove City College, with a BS in International Business and Finance. BG

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Pevarnik Bros., Inc.
Phoenix Roofing, Inc.
Precision Environmental Co.
RAM Acoustical Corp.
Redstone Acoustical & Flooring Company, Inc.
Ruthrauff/Sauer LLC
Sargent Electric Co.
Scalise Industries Corporation
Schnabel Foundation Co.
Songer Steel Services
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Winjen Corp.
Wyatt, Incorporated

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Closing Out

By DeWitt Peart

The Pittsburgh region has been attracting some well-deserved attention in recent years for our story of economic transformation including National Geographic Traveler magazine, which named Pittsburgh a top 20 "best-of-the-world, must-see" destination globally for 2012 and Delta Sky Magazine, which featured Pittsburgh as the "Comeback City" in its June 2012 issue worldwide. It is important to note that these accolades are usually based on metropolitan statistical area (MSA) data including the City of Pittsburgh, so the attention we are receiving is a "win" for our entire region.

Not only are these publications featuring what happened here to drive a 30-year economic, environmental and quality of life transformation, they are increasingly focusing on how it happened. The same question, "How did you do it?" has drawn more than 20 civic leadership delegations here over the past three years since the G-20 summit brought renewed global attention to our region in 2009.

Countless individuals and organizations can share the credit for what has been – and is continuing – to happen here, from our foundational industries in advanced manufacturing, financial and business services, energy, and construction and engineering; to our colleges and universities that have provided the innovation and the entrepreneurs to create new economic strengths in health care and life sciences and information and communications technology; to the government agencies, foundations and nonprofits that enhanced an already high quality of life by investing in arts and culture, outdoor recreation and green building.

There is one ingredient that is common across it all: a willingness to collaborate to meet challenges and capture opportunities, and to cross geographic, organizational and political boundaries. There is no better example than the Pittsburgh Regional Alliance Partnership (PRA), which began in the mid-90s as an effort to create a "one-stop shop" for economic development across the 10 counties of southwestern Pennsylvania. From the beginning the PRA brought together public and private sector leaders concerned about economic growth in the region to share business investment leads and to work together to make sure that prospects located somewhere within the 10 counties rather than in another region.

Since 2003, the PRA has been formally affiliated with the Allegheny Conference on Community Development, the organization that provides leadership and resources to advance the PRA's mission to generate leads and secure business investment across all 10 counties of southwestern Pennsylvania. Representatives from each of these counties serve on the Partnership, along with leaders of such regional organizations as Catalyst Connection, the Pittsburgh Technology Council, and the Regional Industrial Development Corporation. Together they have focused and fine-tuned the program.

The numbers bear this out. In 2002 prior to the affiliation with the Conference, the PRA secured 21 located projects or "wins" as we call them. These wins accounted for $106.5 million in capital investment and created and retained a total of 6,823 jobs. Through 2006, annual wins averaged in the 20s. Over the past five years, through the Great Recession and beyond, our region's collaborative approach has paid real dividends. Annual wins have averaged in the 30s, with a high of 41 located projects in 2008, prior to the recession. In 2010 and 2011 wins returned to pre-recessionary levels. Last year, the PRA facilitated 39 located projects, with $135.5 million in capital commitments – creating and retaining a projected 11,868 jobs.

Last year, Site Selection, using a different measure, ranked the Pittsburgh region third in the country for the total number of business expansions and attractions. Not bad for a region that is about 22nd in market size. A more objective measure of our success is the steadily declining vacancy rate in our region's office and industrial buildings. Full buildings are the result of a robust employment climate and those jobs are the ultimate metric of how our collaboration is working. For the first time in a generation our region is leading the nation out of recession rather than lagging a recovery.

Even better years are ahead for us, I'm convinced. Our region offers a central location, an affordable cost of doing business, a high quality of life, a skilled workforce, excellence in innovation, and a diverse economy, including energy resources above and below ground. Our biggest challenge may be to retain the spirit of collaboration that got us to where we are today. As the economy in some parts of our region improves faster than in others it could become easy to lose sight of the reality that we are in this together, and that by working together, we all achieve more.

The past decade has proven that by collaborating – as Pittsburgh uniquely does – we can overcome significant challenges and position ourselves to lead for years to come.

De Peart is the executive vice-president of economic development for the Allegheny Conference on Community Development and the president of the Pittsburgh Regional Alliance.


setting the
performance
standard
for aggressive schedules