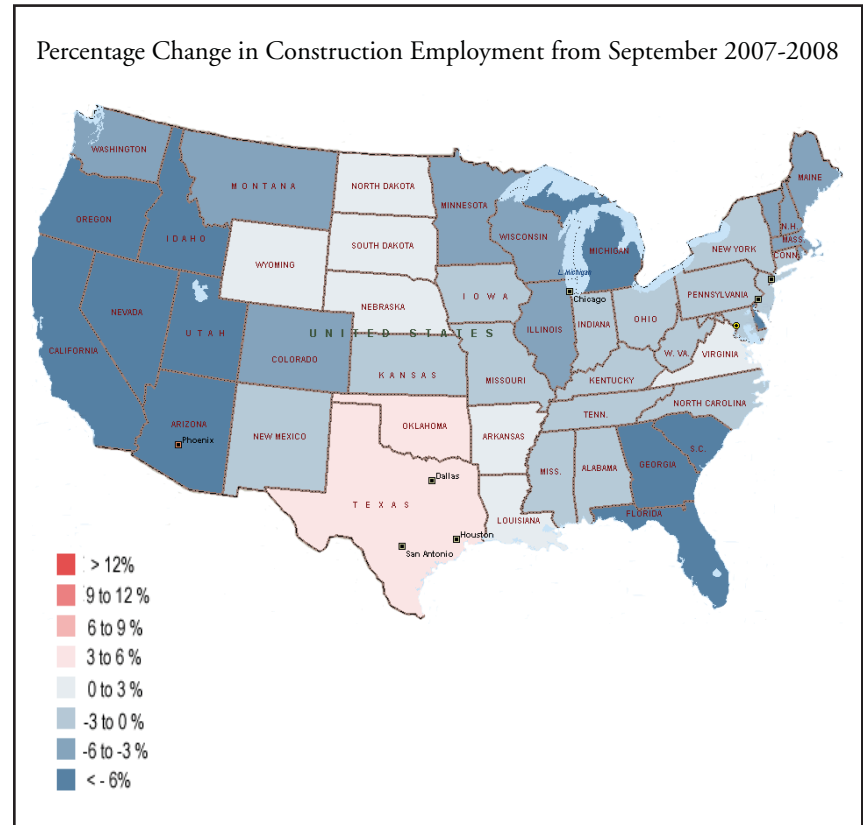


The headline news of the third quarter has been the dramatic movement of both the credit and the stock markets. The credit markets led the turmoil as liquidity and confidence collapsed, leading to the failure of many major institutions and the near failure of many others. Credit flows virtually dried up over a three week period in September and October. The combination of bankruptcy of major financial institutions and concerns over the viability of credit markets triggered worldwide selling of stocks, with most major exchanges registering their largest weekly declines ever, eliminating in some cases one quarter of the nominal stock value. As this is written, there are indications that the credit markets are regaining some stability, but it is likely that the financial markets and the broader economy will remain very fragile for some time to come.

One consequence of the severity of the current credit crisis is that the impact of any intervention should be evident sooner rather than later. The current situation is unsustainable, and there will need to be rapid resolution within the markets, or a rapid worsening until a new point of stability is reached. This stability is not the same as recovery, however, which will take many months, if not years. A clearer picture of the overall fallout from September and October should become available soon.

The impact of recent events on the construction market is yet to be seen. At best, it is likely to lead to reductions in construction activity over the next year, due both to reduction in demand for buildings as the economy weakens, and to the shortage of funds, whether from conventional loans or private equity. If the economy fails to stabilize,

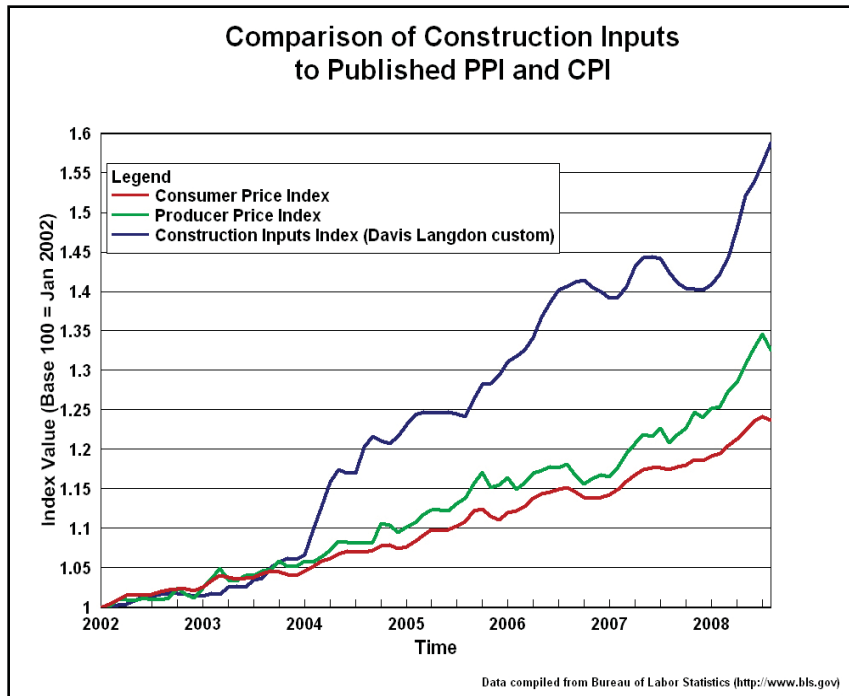


the impact could be far more dramatic, with a prolonged deep recession in the construction industry as cash and credit are directed towards the short term needs of the broader economy.

From a construction cost escalation perspective, the recent economic news is likely to lead to better news. Just as the rapidly growing demand of the past four years led to unprecedented levels of construction escalation, falling demand is leading to decreasing escalation, and even, in some areas, deflation. Commodity prices are trending downwards, and most strategic materials are showing substantial declines. Most notable among these is oil, which has fallen by nearly 50% in recent

months, but steel, copper, lumber, and many other building commodities are also showing signs of price decreases. In most cases these have still to work their way through to building material and in-place costs, but there is already evidence of falling selling prices in some areas.

On the other hand, risk and financing concerns are creating upward indicators for inflation. Risk remains a serious concern for construction projects. Delay and cancellation of projects, even projects under construction, is a growing trend. Reduced availability and increasing cost of financing impacts not only project owners, but also contractors, who rely on financing for working capital during



construction, and bonding and insurance companies, who rely on financing to provide their services for construction. The recent market trouble has clearly increased risk substantially. The impact on the financing, insurance and bonding markets is yet to be seen, but it is likely, if only in the short term, that there will be sharply reduced capacity in the construction market as bidders compete for limited finance and insurance. As a result escalation is likely to vary based on the size and/or the complexity of the project.

The primary concern is the depth and duration of the current construction recession. The current situation has the potential to be very severe and long lived, or short and relatively mild. If the credit markets can recover quickly, and cash starts flowing, it may be possible to keep

the economy in the mild recession that had been expected before September, since the current crisis is far more about liquidity and credit flows than about the broad economy. If, however, the credit freeze triggers reductions in business activity and further failures, there could be a severe fall in overall activity, and a long and deep recession.

Overall, the outlook for construction is quite poor. While escalation is likely to be much lower than in recent years, the level of activity is also likely to be much lower, and there is the possibility of business failures throughout the industry, from owners to contractors to design and consulting services. This possibility has the potential to create a feedback loop of distrust, similar to that which played a large role in the initial credit crisis, amplifying the effect of the initial

shock. There is the possibility of increased government investment in construction and infrastructure as part of an economic stimulus package in coming months, which could help to boost demand, but this is unlikely to be a major contributor to overall volume.

Mid- to long-term prospects

The mid term prospects are highly dependent on the outcome of the next few months. Broadly, the mid to long term prospects are generally good. The overbuilding of 2007 and 2008 should be able to be absorbed in the next two to three years; demand should recover, although the pace of recovery is unclear. Funding remains the most serious concern. If the credit markets remain weak, funding will be a challenge for both the private and the public sector.

Material prices are likely to experience continued volatility as global supply and demand react to each other, with transient surpluses and shortages and the accompanying swings in pricing.

Escalation has the potential to change rapidly in response to changes in the construction market and in the broader economy. The past five years have seen three dramatic changes in the construction market. The first of these, in 2004, was the rapid increase in construction escalation due both to the high level of domestic construction demand, and changes in global commodity demand. The second came at the end of 2007, with the collapse of the residential construction market and the associated liquidity crisis brought on by the failure of the complex financial instruments behind the mortgages. The third is the current collapse of the credit markets. In all three cases the changes

were in response to relatively small initial triggers, and none were foreseen, at least in magnitude or timing. There is a strong possibility that such changes could occur again in the next few years, and escalation could change quickly, and with little warning.

Overall, construction markets and escalation will experience a high degree of uncertainty and volatility. Escalation planning will be marked more by the need to manage the uncertainty than to accommodate the actual escalation rate, and projects will need to recognize that increased risk in the planning process. In many respects the construction market is entering entirely new territory, with factors and conditions that are unprecedented. Traditional responses to these new challenges are unlikely to be adequate.

Direct Costs - Material Prices

Material prices have increased sharply in the past eight months. The reductions due to falling commodity prices have not yet been registered in the indices, however, largely since these lag actual changes by one to two months. As commodity prices fall and demand shrinks, it is likely that material prices will flatten, or fall in the coming months. The US dollar has strengthened moderately in the past year, making global commodities slightly cheaper in the domestic market.

Volatility still remains a concern, with fluctuating prices creating challenges for contractors, and increasing their risk for both price and schedule.

As prices and demand fall, material availability should improve, although there is the possibility of shortages due

to limited funding for manufacturing companies and reduced cash flows from owners and contractors. Shortages and supply challenges can have a significant impact on overall construction costs, both due to premiums paid to expedite materials, and to the costs of delay, extended overhead, liquidated damage risks, and added inflation.

Labor

Labor costs have grown steadily, but with relative stability in the past year, and this pattern is likely to continue for the coming year. Many contracts which were negotiated in the past one to two years are providing for increases in the coming years, despite the weakening economy, and so there will be steady moderate pressure on labor costs. In states where union presence is less evident, the labor cost pressure is likely to be lower due to the increased pool of available workers. Labor unit costs are generally rising at around 4 to 5% per annum in most regions.

Labor availability should improve, particularly in the residential and smaller non-residential projects.

Overall Implications

For construction, as with the wider economy, the future is uncertain. There is no way of knowing how the construction markets will fare over the next one to two years, and no way of forecasting likely cost trends.

For most markets the deflationary effect of falling demand is likely to be the prevailing driver. These include

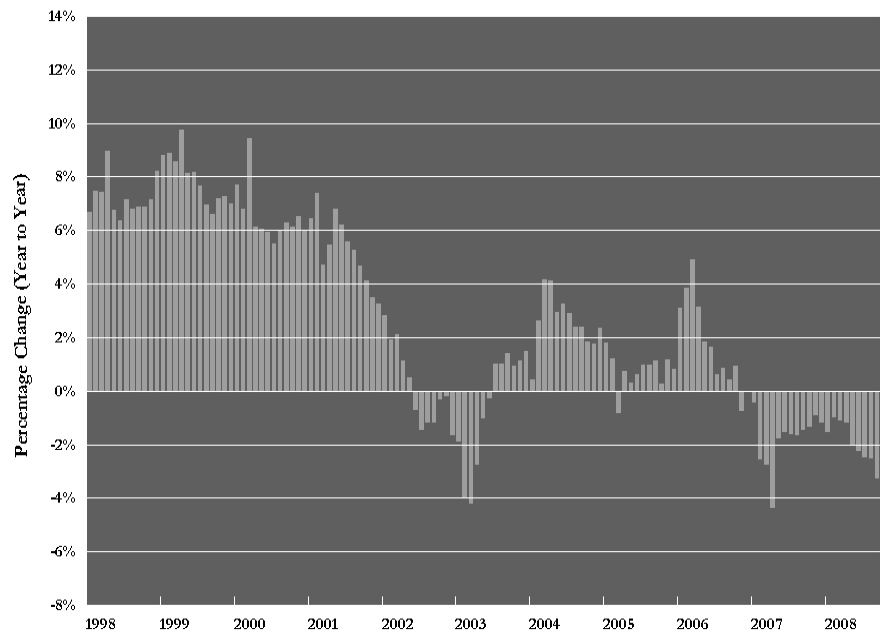
the hitherto strong regions such as the western and southeastern states, and the residential and small, simple non-residential sectors. These markets could experience flat or falling prices, with escalation running from extremes of -10 to -15%, to a more likely range of -3% to +3%.

For markets with limited range to absorb material and risk premiums, escalation is likely to remain high. These include markets with limited contractor pools, such as those for large, complex or specialized projects, or projects with limited bid invitations. These markets could see escalation in the 3 to 5% range.

Within both these pools, there will be aberrations as bidders seek to gauge the competition for any given project. This could lead to localized significant bid overages or savings on individual projects.

Escalation planning will be very difficult for the next two to three years as escalation becomes more reactive to external factors and thus more unpredictable. The best inflation planning will be risk planning; developing risk management protocols to identify and manage the greatly increased risks related to construction costs inherent in the current market. Escalation risk mitigation strategies should include a careful assessment of the appropriate allocation of risk across the project team as far as possible by contractual clauses addressing such issues as material price volatility, financing risk, prompt retention release, and targeted reductions in bonding requirements.

Region I Construction Employment Percent Change

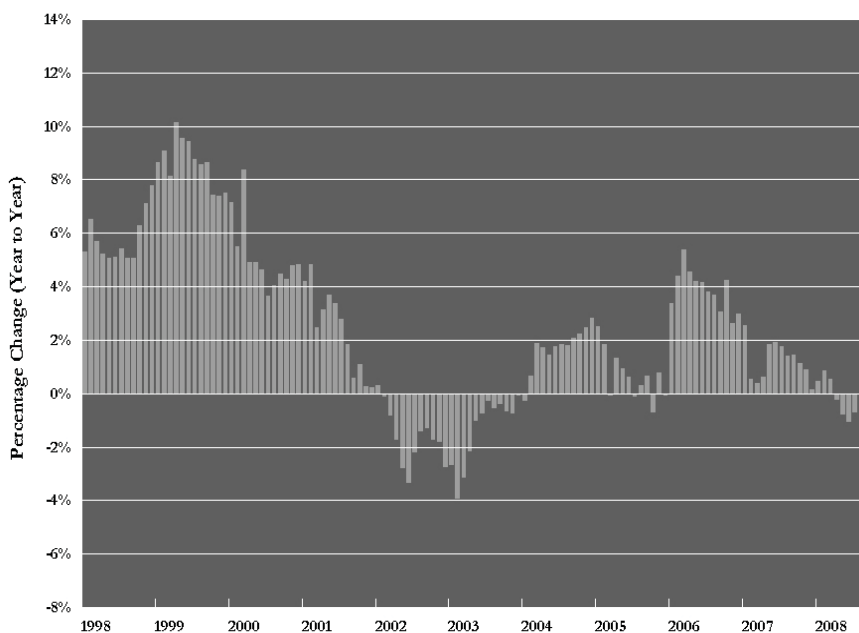


Region I continues to experience a moderate contraction in its construction market, and has now given back much of the growth of the past five years, with activity levels continuing to run close to the levels of 2003. None of the states are showing any sustained strength, as each drifts between 3 to 4% contraction and 1% growth.

The overall economic picture in the region is generally poor. There is weak job growth and a limited prospect for growth in demand for construction services, in the short term. In the longer term, the states in the southern portion of the region have stronger growth prospects. While the slowdown is relatively mild, recovery is likely to be mild also, and may take two to three years at best.

¹ Data in all graphs in this report are from US Bureau of Labor Statistics (<http://www.bls.gov/>)

Region II Construction Employment Percent Change

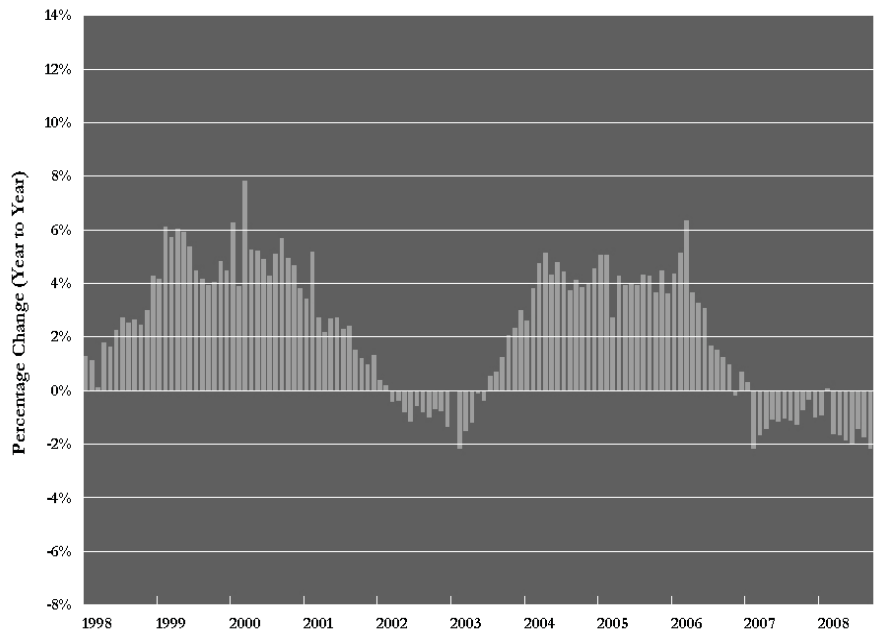


The construction market in Region II has finally entered negative territory, following a steady decline in growth rate over the past two years. Most of this change has taken place in the state of New York, which had been growing moderately strongly, but has turned negative, albeit very slightly. New Jersey has maintained a steady rate of decline at around 2% to 3% per annum.

Even with the slowdown, there is still some residual demand in New York City, and the state as a whole may continue to exhibit some strength as a result, which could soften the decline somewhat in the region. Nevertheless, demand is likely to continue to fall over the coming year.

In the short term, the region is likely to see shrinking construction activity, but perhaps to a lesser extent than the surrounding regions, and the country as a whole. It may also be one of the regions that recovers the quickest, due to the long term economic strength of the region. The strength, however, is concentrated in the areas surrounding New York City. Upstate New York in particular is likely to continue to struggle economically.

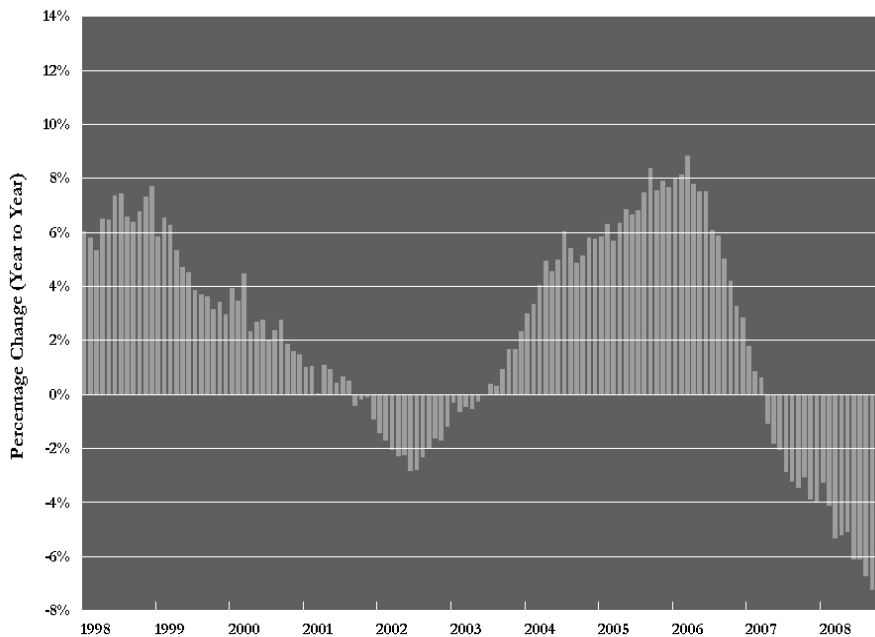
Region III Construction Employment Percent Change



Construction activity in the region continues to slow, and the only portion with moderate strength is the District of Columbia, which is currently showing mild growth in the range of 1%.

The long term economic picture in the region is relatively strong. There is likely to be steady job growth and reasonable prospects for continued long-term demand for construction services. In the short term, however, the region is likely to experience continued job losses and weak demand, along with the rest of the country. The decline will not be as severe as the south east and western portions of the country, and the recovery could be more rapid.

Region IV Construction Employment Percent Change

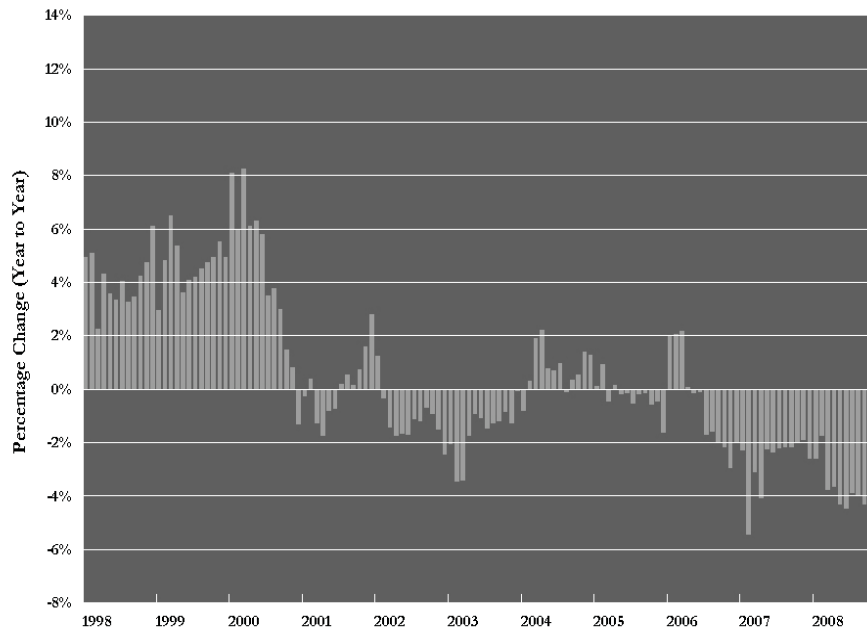


Region IV remains divided into two distinct markets. Georgia and South Carolina have joined Florida in sharp decline, with rates of around 13% per annum in Florida and South Carolina, and 5% in Georgia. Kentucky and Tennessee have fallen off the pace, and have joined Alabama, Mississippi and North Carolina, settled around neutral at plus or minus 1%.

The economic prospects are similarly divided. The Atlantic states have experienced significant overbuilding, particularly in residential and hospitality construction. The backlog will take time to eliminate, and with these sectors being among the most impacted by the current recession, they are unlikely to see a rapid strengthening any time soon. The western portion of the region, on the other hand, experienced far less excess, and has shown remarkable resilience in the past year. Alabama, Mississippi, Kentucky and Tennessee are still showing weak growth, although it is likely they too will fall into mild decline in the coming months.

The underlying trends are still strong, but the recovery is likely to be some way off in this region, with recovery occurring more rapidly in the western states than in the Atlantic ones.

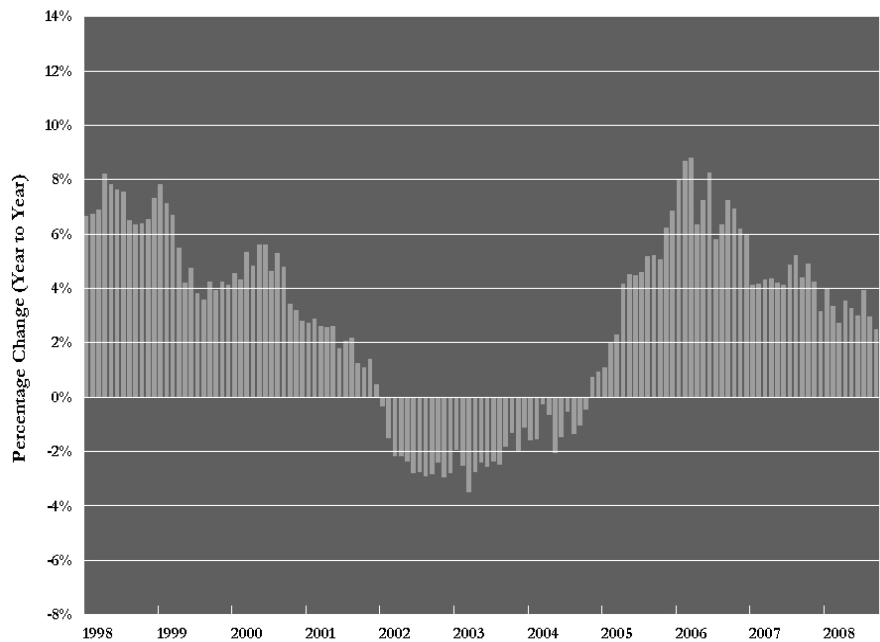
Region V Construction Employment Percent Change



Region V is still the weakest overall construction market in the country. Employment levels have now fallen to the levels last seen in 1997, indicating no net change in construction employment over the past 11 years.

The overall economies in the region are also quite weak, with low employment growth and low economic activity. The region is likely to be severely impacted by the current economic conditions, and there is little sign of a pick up in demand for construction in the region over the next two to four years.

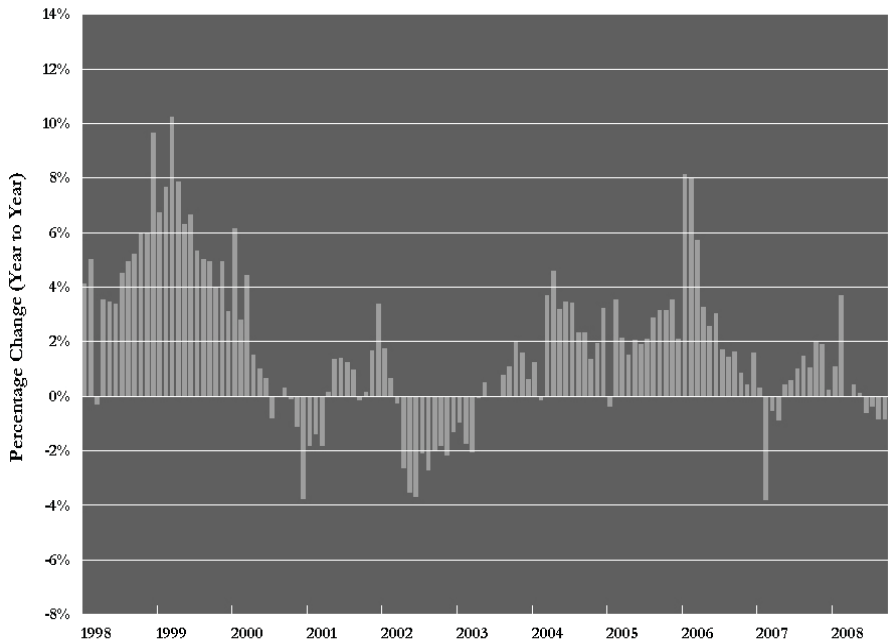
Region VI Construction Employment Percent Change



Region VI is the only region currently showing growth in construction activity, and it contains three of the five states with any appreciable growth. Texas, the biggest state in the region, is also the strongest nationally with growth running at close to 4% per annum, a rate that has been sustained for much of the past two years. The growth is fairly well distributed throughout the region, and has been relatively strong and sustained.

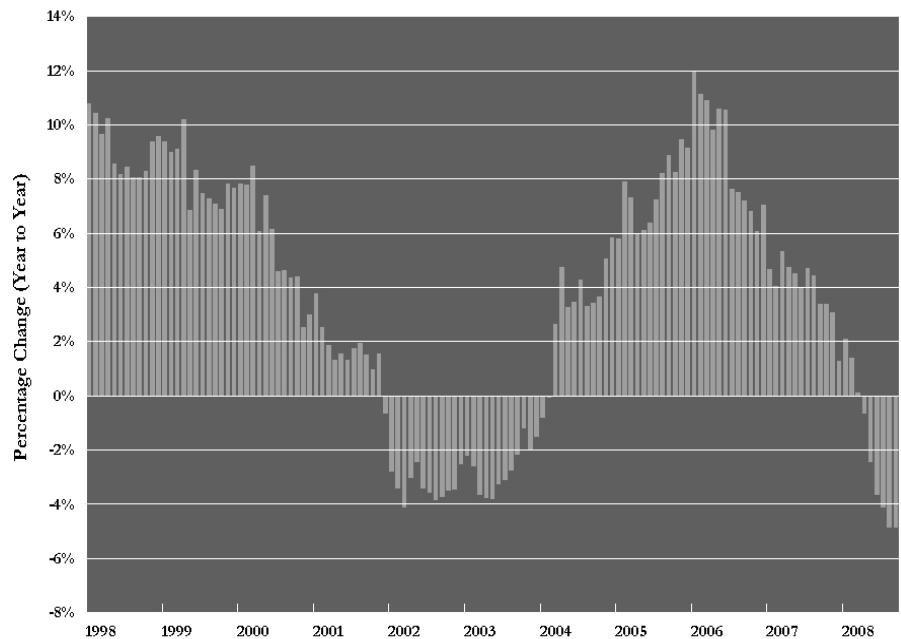
The region also has relatively good economic prospects, both in the short and mid term, although the region is unlikely to escape the effect of the current recession all together. In general, however, the region may experience a shorter downturn, and a quicker recovery than many other areas.

Region VII Construction Employment Percent Change



All the states in region VII are in very mild decline. This region is not one given to rapid changes in activity. It did not participate in the boom of the past four years, and it is likely that the slowdown will be similarly modest, as will be any coming recovery.

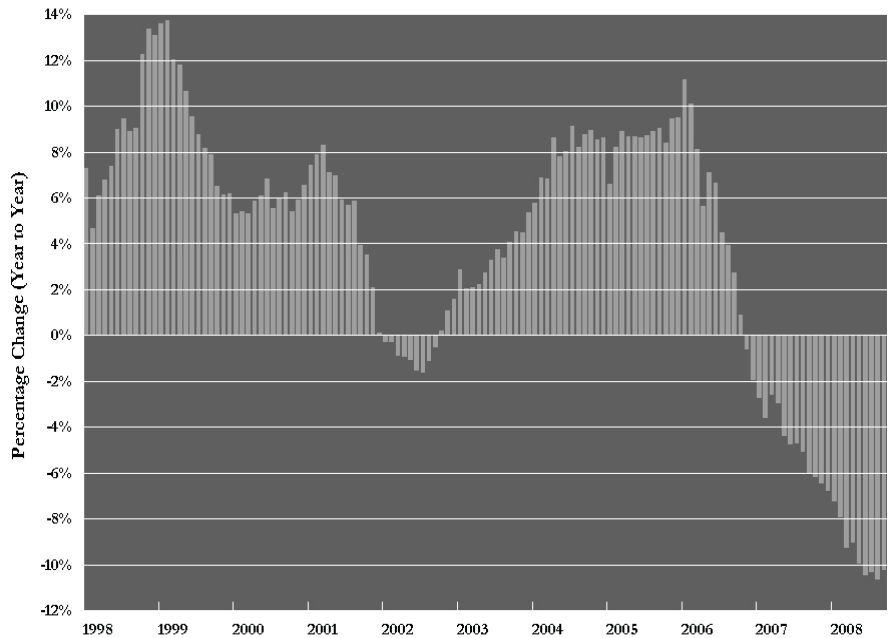
Region VIII Construction Employment Percent Change



Activity in Region VIII has slowed in all states in the region. Wyoming and the Dakotas are still showing modest, but reduced growth. Colorado and Montana are declining moderately. Utah, declining at over 13% per annum, is mirroring its southern and western neighbors in region IX.

In the short term, this region is likely to remain weak. Much of the construction growth had been driven by population movement, particularly in the two largest states of Colorado and Utah. The current economic downturn is dampening that trend, and the weakness in the housing market is likely to keep growth low for some time to come. In the longer term, the region should return to strength, but this may be three or more years away.

Region IX Construction Employment Percent Change

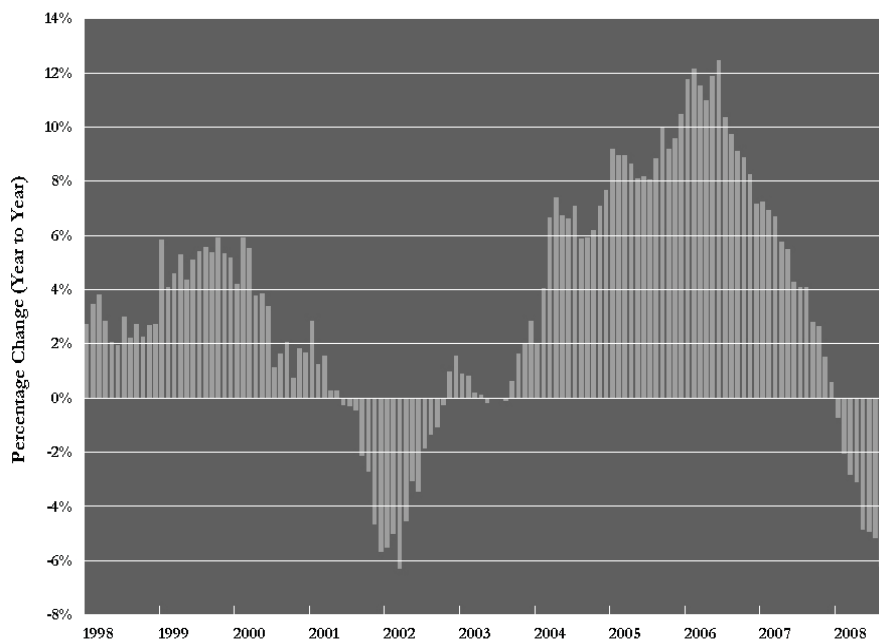


This region is the hardest hit region, and includes the three of the hardest hit states. Arizona, at over 16% decline, is the national leader, but Nevada and California are both declining at around 10% per annum, putting them in the six weakest states overall. Together these states account for roughly 15% of all construction employment nationally, and so the decline in this region is a significant part of the overall national decline. The weakness is largely driven by sharp reductions in housing activity. Non-residential work is declining, but to a lesser degree.

The sharp slowdown in activity has led to substantial excess capacity, particularly in the residential and smaller non-residential sectors, although most sectors have some excess capacity. This has led to some very competitive bidding, with large bid responses, and some very low bids, erasing much of the escalation in the past year.

The economic outlook for the region in the short term is relatively weak. The State of California has significant revenue challenges, and public sector spending is likely to be limited in most sectors. The area has experienced a large degree of overbuilding, particularly in the residential sector. Population growth due to migration has all but stopped due to the fall in the residential market. All of these factors will take some time to correct, and it is likely that any recovery in the region will be slow. In the mid to longer term, the region has the potential for high construction demand to meet population growth and to support the expected long term economic growth.

Region X Construction Employment Percent Change



The rate of decline in construction activity in Region X has continued to grow, and has now reached almost 6% per annum. Washington, by far the largest construction employer in the region, with over half of all construction jobs, is showing only moderate decline at around 2% per annum. The bulk of the fall comes from Oregon and Idaho. Idaho had been one of the strongest growth states in the country in 2006/7, and its decline is largely a correction from the unsustainably high growth of that period. Oregon, on the other hand, had growth closer to that of Washington over the same period, and so its decline is truly representing a shrinking in the overall construction market.

Long term economic prospects in the region remain strong, and the region may be able to recover relatively quickly from the current downturn.