

## ***MEASURES TAKEN TO MANAGE ESCALATING COSTS***

### ***HISTORICALLY HIGH MATERIAL INFLATION***

The market prices for materials and labor are caught at a historic high. A surge in steel prices got inflation rolling in the spring of 2004. Three years later, those higher steel prices are holding firm and being joined by a host of other building materials that are posting double-digit price hikes.

The effect on the entire construction industry and its clients is undeniable. For example, according to a recent edition of Engineering News-Record, an industry business publication, price volatility in the copper market is forcing electrical and plumbing contractors to rethink their bidding procedures for construction projects. In 2006, average copper prices were at \$2.30 per lb. This is compared to \$1.68 in 2005 and \$1.29 in 2004. Vendors are quoting prices that are only good for a matter of hours, making it difficult to forecast where costs will go.

These higher price levels appear to be permanent with strong global demand, a weak dollar, and higher energy costs all supporting a higher cost structure. Costs will continue to climb with the impact of rebuilding New Orleans and the Gulf Coast after recent hurricanes.

### ***REICH'S PLAN TO MANAGE INFLATION***

To combat the escalation in material and labor prices, Reich has set up a successful system of checks and balances for each project. These measures are used to mitigate inflationary costs while maintaining the highest level of quality.

### ***STANDARDIZATION TO MANAGE COST***

To start, we have standardized the design, specifications, and construction procedures to have a major influence on reducing costs.

This is a critical process to approve bids and locking in pricing for materials. For example, steel prices are escalating so quickly that contractors asking for metal routinely receive bids only for a few days, or even hours. Three years ago, a quoted price could often last for a month. Now builders face the same problem for a



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## ***CONSTRUCTION MANAGEMENT***

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host of other materials, including concrete, drywall, lumber, etc.

A strict schedule for deliverables and approvals allows the project team, including the owner, architect, and contractor, to make decisions more quickly and smoothly. Approvals made with confidence and quickness can save thousands of dollars in increased material prices.

### ***BUYING POWER AND ECONOMY OF SCALE***

At any given time throughout the year, Reich Construction Company will have projects in various stages of construction throughout Florida. With numerous projects under construction, we can purchase large quantities of raw materials at reduced unit prices. This will preserve pricing for materials.

### ***VALUE MANAGEMENT***

Organized value management efforts analyze the functional requirements of systems, equipment, facilities, procedures, and supplies for the purpose of achieving essential functions at the lowest total cost, consistent with the needed performance, safety, reliability, quality, and maintainability of the building.

Reich's program can reduce acquisition and ownership costs while maintaining the necessary level of performance. We also maintain a strong focus on products that simplify and reduce labor and installation costs.

The direct benefits include lower costs for acquisition and logistics and increased return-on-investment. Other benefits include improved performance, improved competitive position, relative ease of repair and replacement, elimination of materials, standardization or simplification of operation, and improved use of resources.

Our value management efforts have reduced the cost of construction by as much as \$5M based on a \$100M hotel/multiuse facility. This is money that owners can take off the bottom line or use for upgrades to the buildings.

### ***LONG LEAD PURCHASING***

By getting early price commitments on critical materials, equipment, and supplies, and stock piling materials through long-lead purchasing, we can lock in prices for materials that can be increased by escalation in the marketplace.

### ***LOWERING LABOR COSTS***

Due to the large volume of work throughout the Southeastern United States in both commercial and residential construction, availability of labor has decreased while labor costs have increased. For example, in March 2006, the average skilled labor index for bricklayers, carpenters, and ironworkers posted a 4.1% annual increase in wages. This was up from 3.8% and 3.9% annual increase in March 2005 and 2004.

Reich combats increasing labor costs and availability issues by maintaining a large pool of qualified subcontractors. Our ability to maintain relationships with these reputable subs affords fair market prices for their work. In addition to our stable of regular subcontractors, we continually search out new subcontractors to provide us with competitive pricing for labor and materials. Tight subcontractor management during construction also affords us competitive pricing.

***CONTINGENCY MANAGEMENT***

In most construction budgets, there is an allowance for contingencies or unexpected costs during construction. The amount of contingency is based on historical experience and the expected difficulty of a particular project. For example, we make estimates for cost in five different areas:

- Design development changes
- Schedule adjustments
- General administration changes
- Differing site conditions
- Third party requirements, such as permitting

Reich manages contingency dollars placed in the overall budget by using our extensive historical data and benchmarking construction costs trends. Using these tools, along with detailed pre-construction planning and sub management, we can accurately forecast the budget within 5%.

In conclusion, we predict that cost pressure on materials is the primary element driving cost escalation. However, Reich has the process in place to provide detailed, accurate project budgets and the checks and balances in place to secure the construction budget through the life of a project.