COLORADO CONSTRUCTION MONITOR

An Update from Sherman & Howard's Construction Industry Practice Group

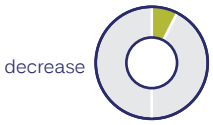
SHERMAN & HOWARD L.L.C.

ESTABLISHED EXCELLENCE

SPRING 2015

SHERMAN & HOWARD CONSTRUCTION INDEX SPRING 2015

111.05



SHERMAN & HOWARD L.L.C.

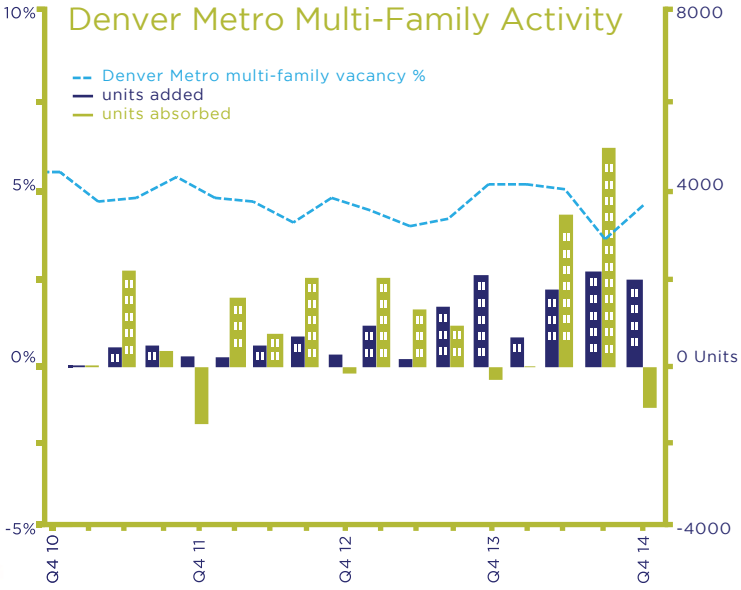
Construction activity in the greater Denver area has been steadily increasing over the past 19 quarters and we don't anticipate much slowing for the remainder of 2015. Construction employment in Colorado grew by a robust 12.54% since this same period last year and totals 138,200 jobs. Analysts forecast the total value of construction spending in 2015 to top $13.4B which should support an additional 8,000 new industry related jobs. The availability of craft labor continues to present a significant hurdle to meeting real demand in the construction industry; although some think it might be one of the only factors preventing over-building within some sectors.

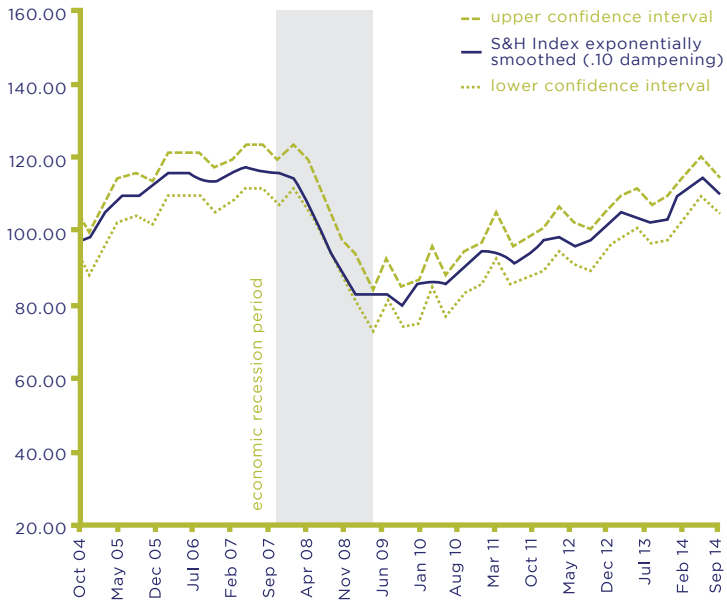
Sherman & Howard's Construction Index currently sits at 111.05, a number not seen since 2007-08. The long-term trend continues to indicate a healthy and growing market locally against a baseline value of 100. Based on current activity, above-baseline market performance should continue for the foreseeable future.

GROUNDBREAKINGS

National Western Complex Redevelopment — $856 million

MSU Aerospace and Engineering Sciences Building — $70 million





The Sherman & Howard Construction Monitor & Index is a statistical indicator of construction-related activity in Colorado and the surrounding intermountain region that provides a three to six month indication of the growth or decline in the industry and its relative health. The Index is determined by several factors considered on a local, regional and nationwide basis, the data for which are collected at least quarterly, including unemployment rates, new permits issued, vacancy and under construction rates, as well as the cost of funds and the competitive condition of the local marketplace. The quarterly Index scores are reported against a baseline of 100, with scores above 100 indicating an increase in related activity and scores below 100 indicating a decline.

Although Sherman & Howard makes efforts to forecast accurately using the most current information, the factors and trends tracked by the Construction Monitor & Index are based on a mathematical regression model that is imperfect and does not measure every possible factor of influence. Nevertheless, we trust the Index we report and accompanying Monitor we issue will serve as a valuable tool for evaluating construction and development opportunities in the Denver area and in the broader Colorado construction market, and for making informed business decisions. Some of the factors used to calculate the Index may be periodically adjusted by various reporting agencies. We regularly monitor those factors and adjust the Index accordingly.

ABOUT THE FIRM

For additional questions please contact
Blane Harvey or David Frommel at 303.297.2900

Sherman & Howard L.L.C. is a super-regional firm with a national practice. While the firm serves a broad range of clients, including individuals, privately held businesses, multi-national corporations and government entities, our Construction Industry Practice Group is one of the largest, if not the largest, dedicated construction law practice in the Rocky Mountain region and features lawyers who focus exclusively on construction. Our attorneys include former architects, engineers, contractors and government attorneys. as well as experienced arbitrators and mediators of construction disputes.

Find more information at www.shermanhoward.com

Spring 2015 Market Update

Sherman & Howard's Construction Index currently sits at 111.05, a number not seen since 2007-08. The long-term trend continues to indicate a healthy and growing market locally against a baseline value of 100. Based on current activity, above-baseline market performance should continue for the foreseeable future.

The Metro Denver economy is firing on all cylinders with a continued net migration into Denver, an unemployment rate hovering around 3.8% and expected population growth of 1.7 - 1.9% in 2015. Business Leader recently named Colorado the nation's third best economy based on a number of factors including: recent changes in housing prices, non-farm payroll job growth, unemployment rate, GDP per capita, average weekly wage, and state government surplus and deficit. The Millennial Generation population is thriving and company expansions within and into the Denver metro region continue to drive growth and expansion of the city. We expect these factors will continue to drive strong construction activity through 2015 and much of 2016.

Construction activity in the greater Denver area has been steadily increasing over the past 19 quarters and we don't anticipate much slowing for several more quarters. Construction employment in Colorado grew by a robust 12.54% since this same period last year and totals 138,200 jobs. Analysts forecast the total value of construction spending in 2015 to top $13.4B, which should support an additional 8,000 new industry-related jobs. The availability of craft labor continues to present a significant hurdle to meeting real demand in the construction industry; although some think it might be one of the only factors preventing over-building within some sectors.

For Colorado, the wild card on the horizon is the price of oil. While low oil prices stimulate economic growth on a national level, the recent halving of oil prices likely will have a negative impact on Colorado's large concentration of oil and gas extraction workers, which, in Denver, is ten times the national average. The trend of accelerating layoffs in the oil and gas sector is likely to continue, particularly for workers in shale oil fields like those in Colorado, where the costs of extraction are higher. Whether oil pricing significantly impacts employment in Colorado will depend upon how long the price remains low.

Here are some important highlights:

Office / Industrial / Retail Verticals:
All of the major commercial sectors continue to show signs of strong expansion activity. Decreasing vacancy, new construction, high absorption, and increased rental rates point to a healthy market with strong demand through 2015/2016.

- **Office** – Office space construction continues to show high demand within Colorado's central business districts, with signs of moderate growth in suburban locations. Roughly 2.8 million square feet of office space were under construction at the end of 2014, representing a 64% increase since the second quarter of 2014. The Metro Denver market continues to see strong absorption of available space, driving the direct vacancy rate down to 10.4%. Union Station continues to be the epicenter of Denver's office space development with the recent influx of new retail and housing options nearby. Office lease rates in the area are some of the highest per square foot in all of Denver.

- **Industrial** – Denver's industrial construction market ended 2014 at unprecedented levels, with vacancy at a historic low rate of 3.2%, which is 0.6 percentage points below this same period last year. Asking lease rates for industrial space hover at the highest levels ever seen, and construction activity in this sector is approaching pre-recession levels. Colorado's legal marijuana industry has catalyzed some of the demand, helping drive absorption of marginal and obsolete class B and C buildings at higher-than-expected lease rates. This trend has migrated up the asset class causing an historic spike of demand within the market. The supply of industrial space is driven even lower by conversion of suburban industrial land to office, multifamily and retail uses. As a result, the market currently supports some of the highest levels of industrial construction since the mid-2000s, with 1.4M sq. ft. now under construction. 2015 may be an even tighter

market as the new product being developed is immediately absorbed and, in some cases, fully pre-leased before construction is complete.

- **Retail** – At the close of 2014, retail vacancy in the metro area was reported at 5.7%, down 0.5 percent from last year and approaching the lowest vacancy rates seen over the past decade. There is very short supply in Class A space driven by the needs of large national chains, although demand varies widely depending upon size and location. At the end of 2014 an estimated 1M square feet of retail space was under construction in the Denver metro area.

Residential:
Multifamily remains the top driver for construction in the Denver metro area with strong population growth and forecasted net migration of 56,000 in 2015. Permit activity in 2014 exceeded 2013 by almost 6% with issued permits at the highest level since 2002. Expect permits for 12,500 units to be issued, and nearly 11,000 apartment units added in 2015. Some analysts think multifamily construction will reach its maximum level of absorption in 2015, although we do not expect the pace of multifamily construction to slow until vacancy rates creep above 6.5%. Denver has not yet recovered from the lack of new units during the Great Recession, and some analysts predict it could take another four to five years of healthy construction activity to make up for the shortage of units constructed during that period. Transit Oriented Development (TOD) areas still seem to be a major focus, although the state still has yet to address the risk of construction defect litigation that inhibits growth in affordable unit and condo construction. Although a controversial piece of legislation (Senate Bill 117) recently passed the Senate at the time of publication, we anticipate it will eventually be rejected in the Colorado State House. Expect to see more municipalities address this issue through local ordinances during 2015 aimed at promoting for-sale multifamily development.

Infrastructure:
The diminished reliability of Federal Lawmakers to pass any long-term solution to the Highway Trust Fund is causing uncertainty in long-term infrastructure projects, and has many lawmakers looking for solutions to funding gaps elsewhere. Unfortunately the economic upswing in Colorado may not yield significant increases in state spending on important infrastructure projects, such as redevelopment of the I-70 viaduct through the north side of downtown Denver. Growth of the state budget is limited by the Taxpayer Bill of Rights, and the Office of State Planning and Budgeting projects taxpayer refunds under TABOR of up to $220 million next year, limiting the availability of general fund dollars for much needed state projects.

Despite the impact of TABOR refunds, the available money in the general fund is still projected to increase by as much as 8.7% next year to more than $800 million. Various funding mandates and restrictions on spending will determine how those funds will be spent. One conflict is arising with Senate Bill 228, which was passed in 2009. This bill allocated approximately $1 billion of general-fund money to be directed toward transportation needs over the next five years once Coloradans' personal income grew by a certain level. Unfortunately SB228 also limits or even eliminates these allocations should the TABOR refund exceed 1% of the total general fund revenues, meaning that five years of funding could be cut to just two or three if TABOR refunds are seen in multiple years. Infrastructure projects also must compete for general-fund dollars with Amendment 23, which passed in 2000, and mandates increases to education funding. Under one interpretation, state funding for schools is roughly $900 million short of the amount Amendment 23 currently requires and a lawsuit has been filed to enforce the increased spending limits. Resolution of the Amendment 23 litigation in favor of additional education spending could severely impact the availability of general fund money to finance much needed state-sponsored infrastructure requirements.

Lending:
During January, the Federal Reserve Board saw a continued easing of lending standards and terms for many loan categories based on heightened competition for lending and a more favorable economic outlook. Despite tightening of lending in specific markets such as oil and gas, the overall easing trend has now extended to 15

consecutive quarters. Although the Federal Reserve recently ended its monthly bond purchasing program, which was designed to hold down long-term interest rates, lending rates have remained low. Federal Reserve Chair Janet Yellen has signaled the central bank isn't yet ready to raise U.S. interest rates from record lows, where they are expected to remain for some time.

The link to access the Summer 2014 Sherman & Howard Construction Monitor is: http://shermanhoward.com/-publications/sherman-howard-construction-monitor-summer-2014/.

Senate Bills Tackle Construction Defect Litigation Reform

By Scott Shea and John Mill

FOREWARD:
Local government officials recognize the risk of construction defect litigation is impeding much-needed condominium construction. This Construction Advisory (published February 2015) discusses proposed reforms introduced in Senate Bill 177. Unfortunately, in a recent article by Marianne Goodland in The Colorado Statesman it was expressed that this issue would probably not be resolved this year:

> .....Among the priorities for the Republican led Senate is Senate Bill 15-177, but Hullinghorst (Speaker of the House Dickey Lee Hullinghorst, D-Boulder) indicated it is a nonstarter in the House. "We're willing to consider" how to define the problem and amend the bill to solve that, but she called the Senate bill "terrible", and said that it takes away homeowners rights. "This is a market issue," not a construction defects problem, she opined. "The impact of construction defects as it relates to builders is highly exaggerated"

You can read the full article here: http://coloradostatesman.com/content/995447-hullinghorst-construction-defects-bill-%3Fnon-starter%3F.

Two bills recently introduced in the Colorado Senate propose to change Colorado's construction defect claims process.If passed, Senate Bill 15-177 would amend Colorado's Common Interest Ownership Act, C.R.S. § 38-33.3-101 et seq., to encourage alternative dispute resolution and require more transparency in construction defect litigation involving condominium developments. The second bill, Senate Bill 15-091, would shorten the time period for bringing construction defect claims.

The aim of Senate Bill 15-177 is to encourage early resolution of construction defect disputes and, if that's not possible, to get more construction defect claims into arbitration instead of court. To that end, it requires homeowners associations to mediate construction defect claims, and it encourages alternative dispute resolution by rendering ineffective any amendment to condominium declarations that changes or removes a mandatory arbitration provision applicable to construction defect claims.

The bill would also require condominium associations to provide specific information to their members about the potential consequences asserting defect claims may have on their asset. That information includes the anticipated cost of pursuing claims, how the association will fund the action, the impact the action may have on the value and marketability of their condos, the anticipated duration of the action, and the likelihood of success. The bill would also require a majority vote of all condominium owners to approve a construction defect action.

Senate Bill 15-091 would cut in half the amount of time a party has to bring construction defect claims. Currently, claims must be brought within 6 years of substantial completion of the project, unless the defect is discovered in year 5 or 6. In that case, the claimant has 2 years after discovery of the physical manifestations of the defect to bring suit. SB 15-091 would reduce to 3 years the time in which a suit may be brought, unless the defect is discovered in year 3, in which case an additional year after discovery to bring suit is permitted. If successful, Colorado would have one of the shortest statutes of repose in the country.

Sherman & Howard predicts the Republican controlled Senate will pass Senate Bill 15-177, however the Democratic controlled House of Representatives will likely postpone any action on the bill indefinitely without bringing it up for a vote. We predict Senate Bill 15-091 will fail in the Senate, or may be postponed indefinitely without a vote. The legislative session ends on May 6, 2015. Senate Bill 15-177 has both significant support and significant opposition, so the bill's ultimate fate is uncertain. Sherman & Howard will continue to monitor these bills in the General Assembly and will provide updates on significant legislative developments.

Potential Source of Lawful Labor Delayed or Halted

By Carol Hildebrand

FOREWARD:
Immigration reform has been a contentious issue this year, and this Construction Advisory (published February 2015) outlines the potential impact and volume of the President Obama's Executive Order to help grant U.S. Work authorization for a population of undocumented workers.

In November 2014 President Obama announced an Executive Order for the Department of Homeland Security and its immigration-related divisions. The agency was to deprioritize deportation of certain aliens unlawfully in the U.S. and grant each a 3-year work permit. The link to our earlier description of the Order and its potential workforce advantage is: http://shermanhoward.com/publications/temporary-federal-immigration-relief-may-help-address-construction-labor-shortages/.

A federal court has now temporarily enjoined the implementation of that Order to the extent it created an expanded Deferred Action for Childhood Arrivals (DACA) and a new category of persons eligible for deferred action because they are parents of U.S. citizens or lawful permanent residents. That program is known as Deferred Action for Parental Accountability (DAPA).

Attorneys General of several states had brought the action. An appeal by the U.S. Department of Justice is underway which might yet result in both programs becoming available. Approximately 4 million aliens are thought likely to gain temporary work authorization if the Executive Order is allowed to be implemented.
future debate on construction defects.

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Sherman & Howard
Construction Practice Group

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