The Industrial
O·U·T·L·O·O·K

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Revolution in Design-Build

Exactly what is design-build and why has it become so popular in recent years? Design-build is a facility project delivery method where the owner has a contract with one entity as a single point of responsibility for both design and construction. Under this method, the owner or consultant hired by the owner establishes the preliminary parameters of the project, typically through a request-for-proposal (RFP) letter.

Design-build offers several advantages over traditional design-bid construction practices. In design-build, a single entity (the contractor) is responsible for quality, cost, and schedule control. This reduces the adversarial relationship between the architect and general contractor and promotes collaborative communication between the two parties. The resulting amicable relationship compresses and streamlines the design process, which lowers administrative costs and increases the probability of the project remaining on schedule. By utilizing this project delivery method, guaranteed construction costs and savings associated with value engineering are identified early in the process. In addition, procurement and construction work can begin before working drawings are fully completed which significantly reduces design and construction changes and total construction time needed to complete the project.

While the advantages of design-build are numerous, there are several distinct shortcomings inherent to this

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How Large is the U.S. Logistics Market?

According to logistics guru, Robert D. Delaney, the 1996 figure is $797 billion. For the past 8 years Delaney's *State of Logistics Report* has been the lone study in the field to attempt to quantify the size of the logistics market and the impact logistics has on the U.S. economy.

In this study, Delaney divides logistics expenditures into 3 main categories: carrying costs, transportation and administration. Carrying costs and transportation represent the majority of logistics costs at $311 billion and $451 billion, respectively. Administration accounts for a mere $35 billion annually.

Interestingly, trucking costs account for over 80% of all transportation costs, or $362 billion per year. Trucking costs are divided between inter-city - $230 billion and local - $132 billion. Surprisingly, over half (52.6%) of all inter-city trucking is handled by

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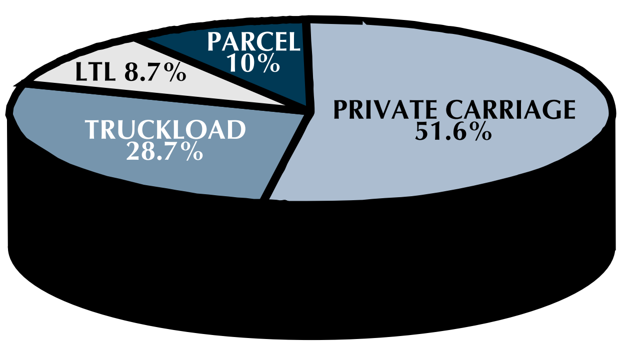
Trucking Industry Breakdown



Source: Robert D. Delaney – State of Logistics Report

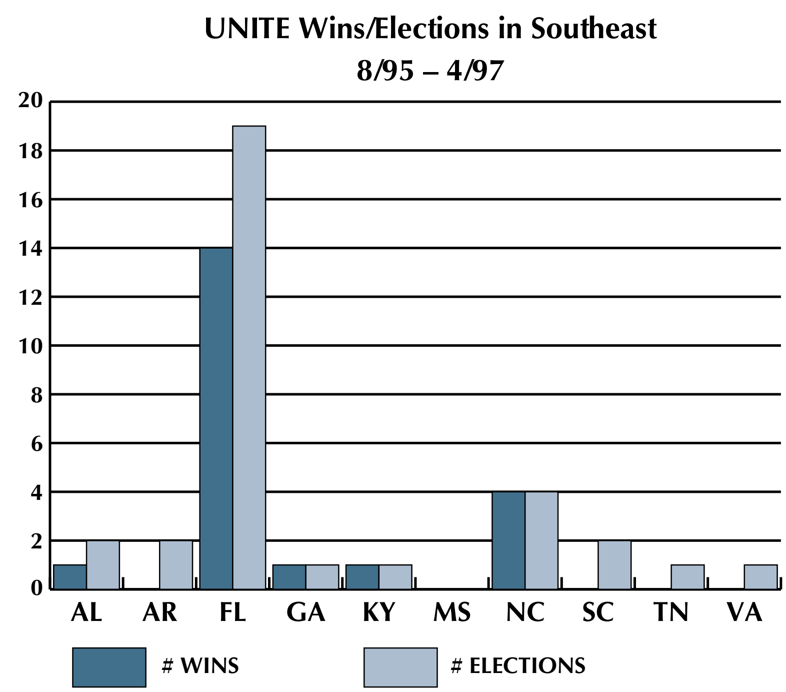
In This Issue

One Union to Fear

As private sector union membership across the country has continued to slide in recent years, the Union of Needle Trades, Industrial and Textile Employees (UNITE) is succeeding where most of its union brothers and sisters are noticeably failing. Focused in the Southeast because of its textile roots, UNITE has recently achieved dramatic success in the Southeast, winning 21 of 33 or 63.6% of its elections from 8/95 - 4/97. In contrast, unions are successful in only 42% of all elections throughout the United States. While UNITE's success rate is impressive, the fact that it was accomplished in the union-averse Southeast is nothing short of miraculous.

A Southeast state-by-state analysis of elections during this time period reveals that UNITE was most successful in Florida (14 wins in 19 elections), a state where a mere 7.9% of private sector manufacturers are organized. The union was also a perfect 4 for 4 in North Carolina. The success in North Carolina is remarkable because this state owns the distinction of having the lowest percentage of organized private sector manufacturers in the country.

Why is this union so successful? One reason many people cite is the tenacity of this organization. For instance, UNITE recently won an election at a Tultex facility in Martinsville, VA on its sixth election attempt. Whatever the reasons for its recent success, UNITE has most certainly proved itself a union to fear. ❑



Source: The Walker Companies

Have Your Cake and Eat It Too

While all corporations are aware of conventional leasing and traditional purchase scenarios, most are not familiar with an often more favorable financing mechanism, the synthetic lease. This financing scenario provides the tenant/buyer with many of the advantages of ownership without actually taking title to the asset.

In the synthetic lease arrangement, the lender (typically a local development authority or government body) forms a special purpose entity through which funds will flow. This entity will issue bonds which will be purchased by a bank. The proceeds of the bond purchase are utilized to finance the construction of the facility, as well as the acquisition of the real estate and machinery and equipment. The special purpose entity then enters into a lease arrangement with the lessee. The lessee assumes primary repayment obligations under the financing as well as responsibility for maintenance of and insurance on all improvements. At the end of the lease, the lessee is required to make a balloon payment to reimburse the majority of the original project cost.

While the synthetic lease has some similarities to conventional leasing, the unique benefits which accrue to the lessee through this mechanism are numerous:

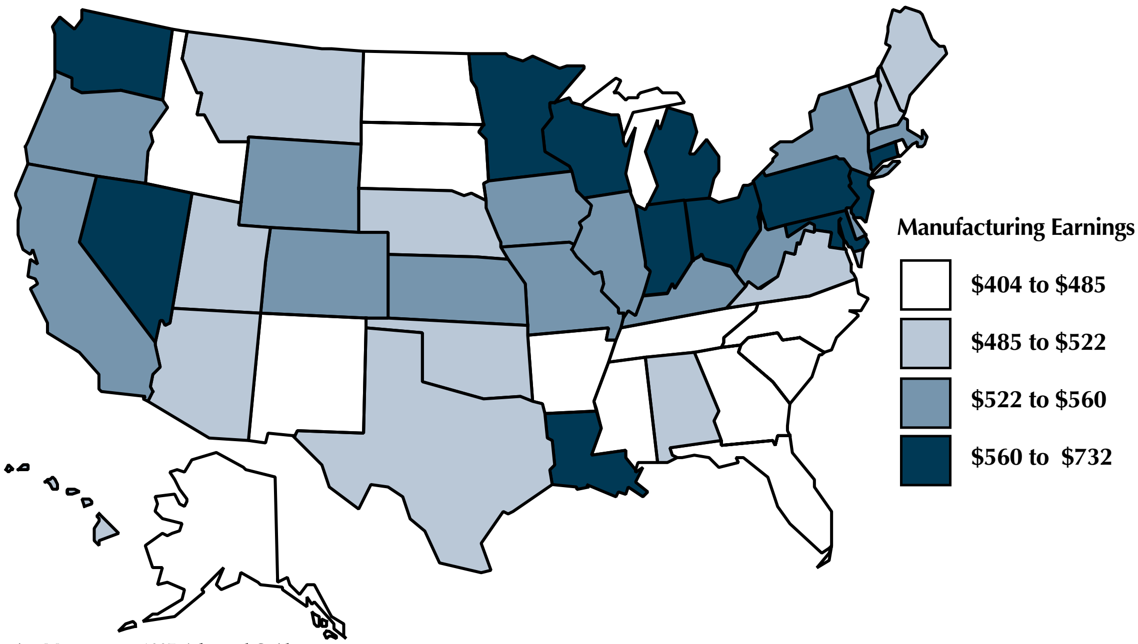
1. A lessee receives the same depreciation tax benefits as an owner.
2. A finance rate 200-300 basis points below conventional financing.
3. The lessee does not have to include depreciation for the purpose of financial accounting reporting

Why Pay More?

Where in the US would one find the states with the lowest and highest manufacturing wage rates? Not surprisingly, most of the inexpensive manufacturing wage states are concentrated in the Southeast and the most expensive in the Midwest and Northeast. In fact, 7 states in the lowest manufacturing wage quintile are located in the Southeastern US. This region also accounts for 3 of the 4 lowest manufacturing wage states: Mississippi ($421 per week), Arkansas ($434 per week) and South Carolina ($435 per week). The lone exception, South Dakota, has the least expensive production wages in the US at $404 per week.

The US average weekly manufacturing wage is $534, and seven states have weekly manufacturing wages in excess of $600. These include: Michigan ($732), Ohio ($649), Indiana ($617), Washington ($616), Louisiana ($614), Connecticut ($610), and Nevada ($603). ❑

1996 Average Weekly Earnings for Manufacturing Workers



Source: Expansion Management 1997 Atlas and Guide

which reflects favorably on earnings.

4. Assets and liabilities related to the facility are not required to be displayed on the balance sheet.
5. All project costs (land, real and personal property and all soft costs) can be pooled and financed together under this mechanism.

The potential downside of synthetic leasing is the risk that the lessee bears upon expiration of the lease. If the lessee desires to remain in the facility, the financing may either be rolled over into another synthetic lease or the financial assets can be procured for the initial project cost.

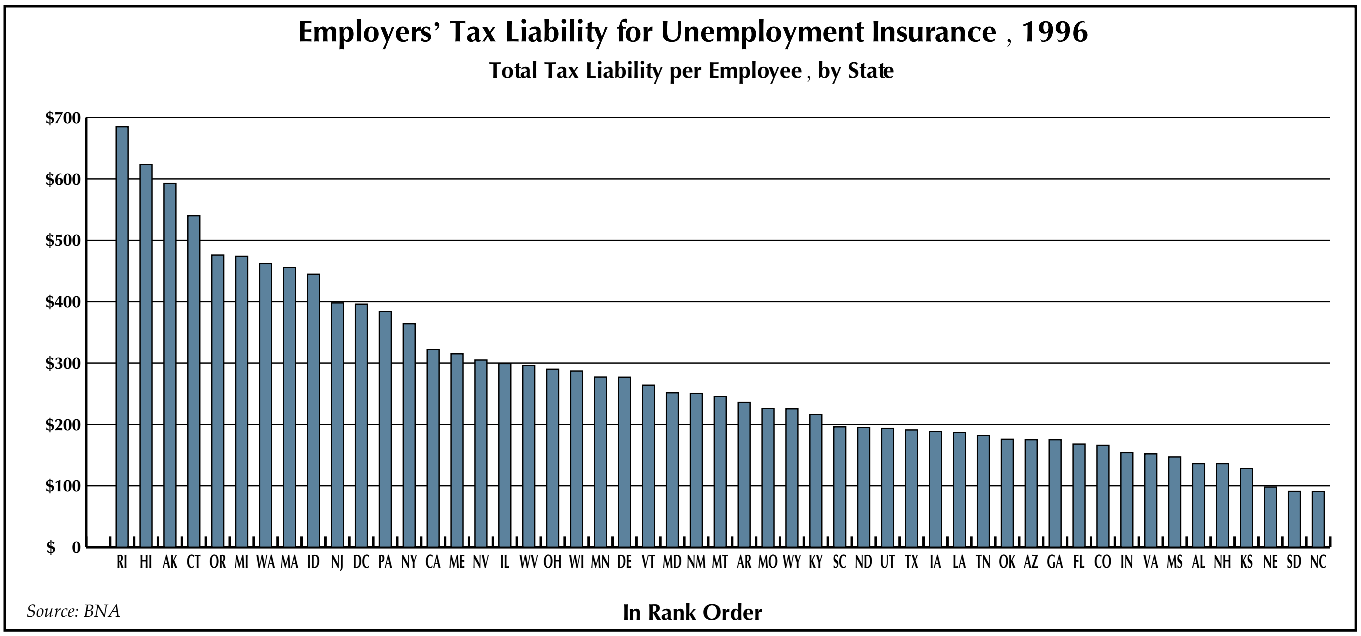
If the lessee wishes to vacate the premises, the tenant can dissolve its obligation by remunerating a contingent minimum payment penalty. This reimbursement is capped at an amount which makes the prearranged minimum payments under the lease obligation equal to 89.9% of the initial project investment.

Although the termination arrangement includes a modest level of inherent risk, synthetic leases are typically less expensive than ownership and conventional financing. For this reason, synthetic leases offer the opportunity for corporate America to have its cake and eat it too. ❑

Location Determines Liability

The average unemployment insurance tax liability for employers was $196 per employee in 1996. Individual states range from a high of $658 per employee in Rhode Island, to a low of $90.80 in North Carolina. An example of a 500 employee facility can help quantify the magnitude of this cost difference. In this case, if a company with an average unemployment insurance history operated a facility employing 500 in North Carolina, the company would stand to save nearly $300,000 annually in unemployment insurance costs compared to a similar facility located in Rhode Island.

Since North Carolina and Rhode Island are not in close proximity, it may be more germane to compare unemployment insurance costs for states located in the same region of the country. Overall unemployment insurance costs are higher in states found in the Northeast and Far West. However, significant differences do exist among neighboring states. Good examples of states that are in close geographic proximity but with wide variability in unemployment insurance tax liability include: New Hampshire ($136) versus Massachusetts ($455.60), Utah ($193.60) versus Idaho ($440.80), and Indiana ($154) versus Michigan ($474). ❑



The Anti-Inflation Fallacy

Wall Street s bulls keep touting how the U.S. economy has entered a new era, a time where the economy enjoys steady growth and inflation is permanently low. While inflation has been kept in check for several years, most people fail to account for the fact that at least some of the inflation slow down can be attributed to the federal government s efforts to improve the accuracy of the Consumer Price Index (CPI).

Since 1995, the U.S. Labor Department has modified its treatment of rents, hospital costs and generic drugs. In addition, this government body has altered the sampling methodology utilized for many food and household products. These and additional changes related to CPI have lowered the present rate of consumer inflation by two tenths to three tenths of a percentage point over the last 2 years. Similar changes planned for 1998 and 1999 will increase the cumulative effect for 1994-1999 to roughly three-quarters of a percentage point.

Since the federal government is not retroactively adjusting inflation figures to reflect the new methodology, inflation currently has and will continue to be understated. For this reason, the Wall Street bull gurus will be wise to factor this bias into any future stock projections which include the assumption of an anti-inflationary landscape. ❑

The Better Marriage

When the Burlington Northern/ Santa Fe (BNSF) and Union Pacific/ Southern Pacific (UPSP) railroad mergers occurred, shippers feared the monopoly power these railroads might potentially enjoy in certain markets. The railroads assured skeptical shippers that the government s Surface Transportation Board would ensure a competitive rail situation providing non-monopolistic pricing and quality service. In fact, the railroads promised the mergers would yield improved service and lower costs which would be passed through to the consumer.

Although both mergers would still be classified as work in progress, a review of the early success of these marriages from a customer's perspective offers surprising results. Since the BNSF consolidation combined contiguous railroads and the UPSP alliance married parallel routes, the latter was forecast to have significantly less benefit to the consumer and therefore, encountered greater opposition.

Thus far, the more recent UPSP merger has generated better results for the customer. While the new alliance has experienced some service difficulties, customers describe UPSP as more efficient than BNSF. The UPSP union has also been more flexible in its pricing practices offering the lower of the UP or SP rate in lanes previously served by both railroads. In similar situations, BNSF has chosen to utilize SF rates, which are typically higher than BN prices. In addition to adopting the higher rate scale, the BNSF consolidation has been riddled by system integration problems, poor customer service and a shortage of equipment.

Already ahead of its competitor, UP s industry standard operational procedures and deep pockets will likely make its union the more successful one for the customer moving forward. In addition, the parallel lines will avail the UPSF the unique opportunity to segment rail traffic based on speed. Subdividing traffic in this manner will eliminate bottle necks in the system significantly reducing travel time for speedier shipments such as intermodal traffic.

While customers will likely benefit from the UPSP merger in most instances, potential problems exist in regions where the merger has narrowed shipping options from two to a single carrier. These areas are referred to as "2 to 1 route areas". While the Surface Transportation Board dictates that UPSP provide BNSF access to these areas, the UPSP controls switching in these areas and therefore has the ability to impede BNSF's access to these customers. The sheer size of UPSP also dictates that many customers have to utilize this railroad in certain regions. For this reason, customers may be reticent to switch to BNSF service in 2 to 1 zones due to a fear of retaliation by the UPSP in the form of canceling its service contract or raising rates in captive markets. ❑

"U.S. Logistics" – continued from pg. 1

private carriers. The remainder is transported via truckload (28.7%), LTL (8.7%), and parcel (10%).

Other noteworthy trends identified in Delaney's study include both the relationship of expenses and transportation costs to GDP. Over the last decade, logistics expenses as a percentage of GDP have dropped from 12.3% to 10.5%. Transportation costs as a percentage of GDP have fallen from 7.6% in 1980 to a mere 6% in 1996. This significant reduction in costs supports the contention that the deregulation of transportation which began in 1980 accelerated competition among carriers, which in turn, reduced costs. ❑

LOGISTICS BALANCE SHEET (Billions $'s)

Carrying Costs	
Interest	$69
Taxes, Obsolescence, Depreciation, Insurance	$175
Warehousing	$67
	$311
Transportation Costs – Motor Carriers	
Truck – Intercity	$230
Truck – Local	$132
Other Carriers	
Railroads	$35
Water	$22
Oil Pipelines	$8
Air	$19
Forwarders	$5
	$451
Administration Costs	
Shipping Related Costs	$4
Logistics Admin.	$31
	$35
Total Logistics Costs	**$797**

Source: Robert D. Delaney – State of Logistics Report

Where Comped Workers Live

Due to the expansion of managed care, the upward spiral in workers' compensation costs has abated some over the last few years. However, as managed care becomes increasingly prevalent, the ability to squeeze costs from the workers' compensation system will lessen and a rise in these costs will likely resume.

Given this fact, employers need to be cognizant of workers' compensation costs and keep a keen eye on the changing landscape of the workers' compensation operating environment in all states in which they operate.

An annual workers' compensation study conducted by Actuarial & Technical Solutions, Inc. provides a good overview of the comparative cost between states to acquire workers' compensation coverage. The study assumes coverage is acquired in the voluntary market and is based on a uniform payroll distribution (the same manufacturing job classifications) to avoid any potential state industry bias. While the analysis does not factor in claims and associated costs, it logically follows that workers' compensation insurance premium costs reflect the overhead associated with claims and therefore have a strong correlation to claims. Due to potentially distorting characteristics of states which administer their workers' compensation system exclusively through a state fund, Nevada, North Dakota, Ohio, West Virginia, Washington, and Wyoming were excluded from the analysis.

States Rank Ordered by Cost to Carry Workers' Compensation in Voluntary Market (1992-1996)

	1992	1993	1994	1995	1996	Net Change 92-96
VA	1	1	1	1	1	0
IN	2	2	2	2	2	0
SC	4	3	3	3	3	1
MD	5	4	6	4	4	1
IA	14	13	9	5	5	9
UT	6	9	4	10	6	0
OR	21	5	5	6	7	14
ID	12	12	10	7	98	4
WI	17	18	19	12	9	8
AR	9	11	11	9	10	-1
NC	3	6	7	8	11	-8
AZ	19	14	16	13	12	7
NE	10	17	18	14	13	-3
AK	27	16	17	16	14	13
MS	13	19	12	11	15	-2
TN	11	10	14	15	16	-5
SD	8	7	15	17	17	-9
NJ	7	15	13	18	18	-11
MN	34	25	22	19	19	15
IL	22	26	25	25	20	2
DE	15	8	8	20	21	-6
CA	40	42	38	29	22	18
KS	18	24	23	23	23	-5
VT	16	20	20	24	24	-8
GA	30	22	21	21	25	5
MO	20	21	30	27	26	-6
AL	25	23	24	28	27	-2
CO	36	37	39	36	28	8
CT	37	34	27	22	29	8
KY	26	27	26	33	30	-4
MA	41	41	33	26	31	10
MI	33	35	34	35	32	1
PA	24	33	29	32	33	-9
NH	30	32	37	34	34	-4
TX	44	43	42	30	35	9
FL	39	39	32	31	36	3
NM	35	31	35	37	37	-2
NY	38	38	43	43	38	0
MT	28	30	31	39	39	-11
OK	32	36	36	38	40	-8
LA	23	29	40	42	41	-18
ME	43	44	44	44	42	1
RI	42	40	41	41	43	-1
HI	29	28	28	40	44	-15

Source: Acturial & Technical Solutions, Inc.

A review of the last 5 years of data from this study sheds some light on the relative attractiveness and changing conditions of the workers' compensation environment in each state. As seen in the accompanying table, Virginia and Indiana have consistently offered the most favorable workers' compensation environments for manufacturing employers in recent years. On the opposite end of the spectrum, Hawaii, Rhode Island, and Maine provided the least attractive workers compensation environment in 1996.

Several states have seen significant improvement in their relative workers compensation ranking from 1992-1996. In 1992, California was ranked 40th, but improved to 22nd last year, for a net change in rankings of +18. Other states showing strong positive changes include: Oregon (+14), Alaska (+13) and Massachusetts (+10). In contrast, Louisiana, Hawaii, New Jersey, and Montana have seen their workers' compensation situation deteriorate significantly by 18 15, 11 and 11 positions in the state rankings, respectively. ❑

Captain Crunch

For the last few years, the states' cry to the federal government has been "free the states from funded and un-funded mandates and allow us to use government funds more efficiently on a localized basis". Ironically, at the same time the states were lobbying for more power and autonomy, states were piling un-funded mandates on counties while appropriating billions of dollars previously apportioned to the counties.

While most states are flush with cash, state mandates leave the average county with discretion over a mere 15% of its budget. In addition, ballot measures or state legislatures in roughly three quarters of states limit the county's ability to increase discretionary funds through its main revenue generator, property taxes.

As a result of the increase in state mandated programs and a reduction in the level of funds allotted to county governments, many U.S. counties are making serious service cutbacks while others teeter on the verge of bankruptcy.

In one particularly troubled community in California, the county jail originally built for 625 inmates currently houses 820, and the juvenile detention hall regularly turns away felons due to a lack of available cells. In addition, the county police force patrols in vehicles with 180,000+ miles and the library hours have been reduced to a mere 18 a week.

Penal system triage (keeping only the hardest cases and releasing the rest), government office closings and the suspension of law enforcement in unincorporated areas of the county have become prevalent in counties throughout the country.

While county distress is more acute in California and a few other large states, many of the U.S.'s 3,000 counties are being squeezed by increasing financial obligations and fixed funding. No longer can one make the assumption that its county level government will be a solvent entity moving forward. ❑

"Design-Build" – continued from pg. 1

construction method. Because of the abbreviated nature of the facility criteria in the RFP's, the contractor has great latitude to specify the quality and character of the improvements. This makes it difficult for the owner to ascertain the tangible nature of the end product and therefore, make a 100% apples-to-apples comparison between the proposals submitted by various general contractors. For this reason, the winning bid is sometimes a low ball offer encompassing a bare bones building which scrimps on the important systems and processes necessary for the client's facility to operate in the most efficient manner.

In addition, because the design and construction responsibilities are handled by one provider, the checks and balances between the architect and contractor inherent in the design-bid project delivery system do not exist. As a result, the owner may not receive objective guidance from the design professional, because he or she is employed by the general contractor. Another drawback is the inherent potential for the owner to lose control over important design decisions.

In an effort to capture the benefits of design-build while eliminating its deficiencies, The Walker Companies developed a hybrid design-build project delivery methodology. Under this approach, the owner's consultant (The Walker Companies) hires an architect at the outset of the project. Once on board, the architect provides more specific design criteria (including conceptual drawings) while simultaneously developing detailed facility specifications. General contractors receive the clearly defined construction drawings and criteria and complete bidding instructions on the new facility. The bid documents require the general contractor to hire the client's architect to complete the design and incorporate his architectural fees in the bid. Although the design professional is paid by the general contractor, the architect's allegiance and loyalty remain with its original client, the owner. Under this scheme, the owner enjoys total control absent from traditional design-build projects.

Because the design professional has been included since the beginning of the project, the most efficient design and systems have been incorporated. The level of detail provided by the drawings and criteria ensures the owner and contractor have a common understanding of the facility criteria <u>before</u> bidding and construction begins. For this reason, the bids in the hybrid design-build offer true apples-to-apples proposals. Many contractors prefer this approach (particularly if it involves a good architect), since the chance of misunderstandings with the owner are greatly diminished.

The Walker Companies' hybrid design-build method gives the owner the greatest protection, while maintaining the valuable benefits of a traditional design-build approach. ❑

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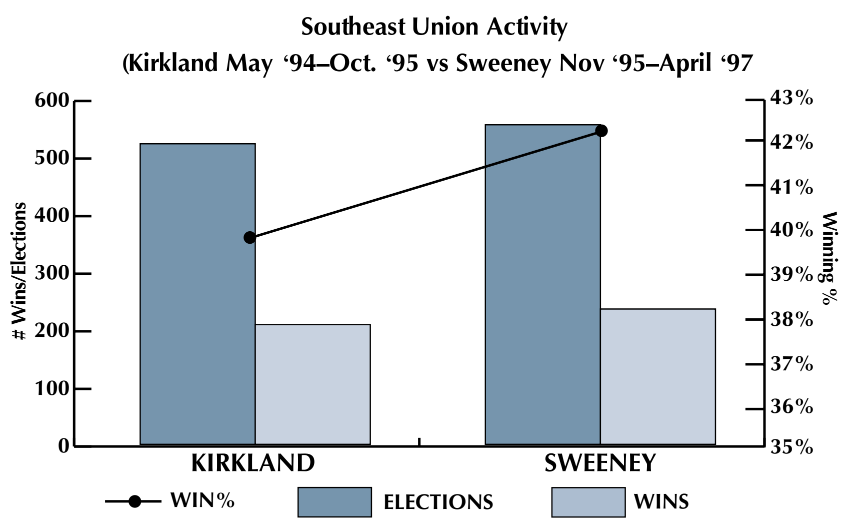
The Sweeney Factor

Prior to John Sweeney's victory in the first ever AFL-CIO presidential election in October 1995, Lane Kirkland, the incumbent, was captain of unions' seemingly sinking ship. Given the tremendous success Sweeney enjoyed as president of the Service Employees International Union, union members had strong reason to feel optimistic about their future at the beginning of his tenure.

From the outset, Sweeney tabbed the union-averse Southeast as a major target for increased organizing efforts. A review of Southeast election activity before and after Sweeney assumed the helm as AFL-CIO president may shed some light on how effective his leadership has been thus far. To this end, The Walker Companies analyzed a 3 year period of Southeast election history (May 1994-April 1997) spanning the final 18 months of Kirkland s tenure and the initial 18 months of Sweeney's regime.

Good news for unions! A review of the aforementioned data reveals that Sweeney's Southeast focus resulted in an increase of elections, union victories, as well as a higher union winning percentage. Over the two 18 month periods analyzed, elections increased from 522 to 555, a 6.3% increase. More impressively, the number of union victories increased 13% jumping from 208 to 235. Finally, the union win ratio in Southeast elections improved from 39.8% to 42.3%. Despite the fact that a variety of societal factors including the economy and the seasonality of elections could have impacted the findings, Sweeney appears to be having a profound impact as the AFL-CIO leader. ❑



Source: The Walker Companies

Atlanta Office
One Georgia Center
600 W. Peachtree Street, Suite 2350
Atlanta, GA 30308
Phone: 404/892-1600
FAX: 404/881-6833

North Carolina Office:
The Atrium at 77 South
4421 Stuart Andrew Blvd., Suite 305
Charlotte, NC 28217
Phone: 704/527-1600
FAX: 704/523-5202

Bulk Rate
U.S. Postage
PAID
Permit No. 747
Atlanta, GA