



Construction National Outlook: November 2009

The end of 2009 brings down the curtain on the most recent seven-year business cycle with a resounding thud. Like with the overall economic cycle, the loss of jobs in construction lags the start of the contraction in construction by six to twelve months, and at year's end the deepest construction job losses in a generation had occurred. According to the Bureau of Labor Statistics construction employment is 15% lower than October 2008. Maintaining the cyclical trend, losses in non-residential labor and crafts were even with the average monthly loss of the past year, or slightly more than 50,000 jobs, while losses in residential employment had slowed to about one-third the average monthly loss over the same period. If the cycle holds form non-residential job losses should ease in coming months as a recovery begins.

Looking towards the other side of this recession, a quartet of national construction economists weighed in on their view of how this business cycle would unwind.

Robert Murray has been the vice president of economic affairs for McGraw-Hill Construction (MHC) for over 15 years. McGraw-Hill has been reporting modest improvement in several construction sectors since spring, but has seen the overall level of construction decline precipitously. The company's forecast is for the first stages of a rebound in 2010. Their forecast is for the level of construction starts in 2010 to climb 11%, following the 25% decline predicted for 2009.

"The U.S. construction market in 2010 will be helped by growth for several sectors, following three straight years of decline that brought total construction activity down 39% from its mid-decade peak," says Murray. "The benefits from the stimulus act will broaden in scope, lifting not just highway construction but also environmental public works and several institutional structure types. With continued improvement expected for single family housing, after reaching bottom earlier this year, the overall level of construction activity should see moderate expansion in 2010."

MHC predicts that single-family housing for 2010 will advance 32% in dollars, corresponding to a 30% increase in the number of units to 560,000 (McGraw-Hill Construction basis). Multifamily housing will improve 16% in dollars and 14% in units, after steep reductions in 2008 and 2009. Commercial buildings will drop 4% in dollars, following a steep 43% drop in 2009. The weak employment picture will further depress occupancies, making it even more difficult to justify new construction. Institutional buildings will begin to stabilize after losing momentum in 2009. Square footage will retreat another 2% after sliding 23% this year. The dollar amount of construction for this sector will edge up 1%, helped by a growing amount of energy-efficiency upgrades to federal buildings and continued strength for military buildings. Manufacturing buildings will drop 14% in dollars and 3% in square feet, hampered by the substantial amount of slack manufacturing capacity. Public works construction is expected to rise 14%, given more wide-ranging strength across all

project types. Electric utility construction will slip 3%, continuing to settle back after a record high in 2008.

Murray warns that the monthly data continues to suggest that any improvement in 2010 is not likely to follow a straight line. "The September decline for construction starts is one more reminder that the very modest upward trend that seemed to take hold during the spring will be uneven and at times halting," he says. "More of this uneven performance can be expected in coming months, given the divergent behavior from construction's main sectors. On the plus side, the steep decline for single family housing has reached its end, and funding from the stimulus act is beginning to have a broader impact beyond highways and bridges."

Ken Simonson, economist for the Associated General Contractors of America, sees opportunities for building contractors from the delayed impact of the ARRA funding, but his forecast is for continued softening in demand for construction.

"Expect to see some improvements in areas that are consumer or stimulus driven, like retail, higher education and hospitals, but not enough to offset further declines in office, hospitality, warehouses and spending at the state and municipal levels," predicts Simonson. AGC sees an overall decline approaching four percent, with non-residential down about five percent, offsetting an expected increase in residential spending.

Simonson again encourages contractors that the stimulus impact will be greater in the building sector in 2010.

"Even though there was \$35 billion in ARRA to go directly to building construction, the distribution was spread among many more agencies than the infrastructure spending, and many were not prepared," he says. "I talked with a contractor in Lexington KY, for example, who told of winning a contract to do a renovation at a national park. There were no problems but the contracting officer asked if he could wait six to eight weeks for the preconstruction meeting because he was swamped processing other contracts."

Simonson says that the consolation is that more stimulus dollars are still to come in 2010 for buildings than for infrastructure. His biggest worry heading into 2010 is the specter of rising material costs, which he predicts will top five percent, and could go higher if some of the larger nations see recovery early in the year. Such a run up could derail a fragile real estate recovery here if costs get ahead of budgets.

Business conditions will improve in 2010 because cyclical automatic recessionary correction mechanisms will go into effect, rather than more government intervention, according to James Haughey, of Reed Construction Market Data. Haughey believes that most businesses took their medicine in 2009, drastically reducing inventories and cutting back production. The result will be positive cyclical corrections going forward. But, he warns, no significant growth is in the offing.

"The stimulus impact is now mostly behind us. Certainly there will be less impact in 2010," Haughey says. "The major economic improvements will come from cyclical recovery factors. I think we'll see GDP begin to recover in the third quarter of this year, maybe as much as three percent. There is already GDP growth in the economies of some of our foreign trading partners. Credit is starting to ease, and the credit problems next year will be with smaller and regional banks, and specialty credit firms, like retail factoring companies."

Haughey's forecast is for modest improvement; however, not all sectors will see it. Reed predicts double digit declines in office, warehousing, hotels, and power generation, which grew well ahead of demand over the past few years. Moreover, he sees an extended period of cyclical correction, especially for sectors in the most distress.

"Although there will be improvements, credit problems will persist systemically through 2011-2012, but the headaches should be more steady than dramatic," he says. "There will be surplus space through next year, foreclosures will continue to rise until mid-2010, public construction will be well off due to sharply lower tax revenues, and costs will begin to rise ahead of inflation. It looks as if it will be 2012 before we regain the peak level of construction of 2006."

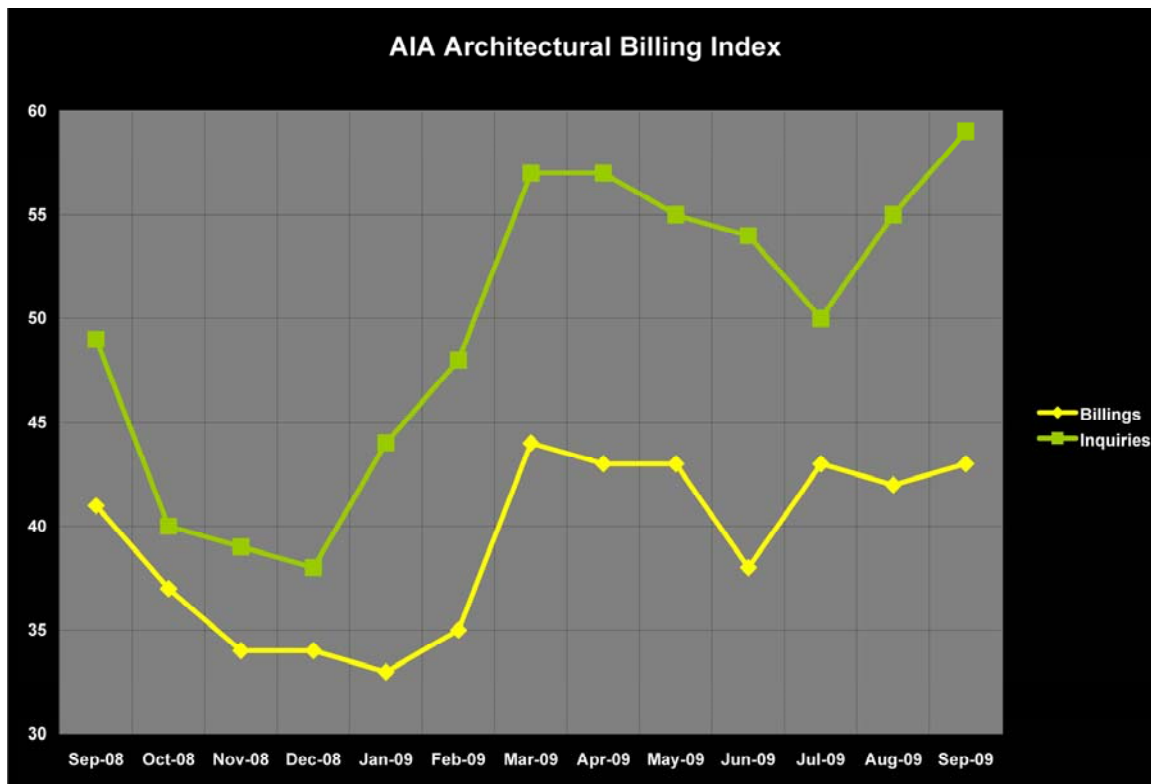
The housing market is the area that offers the most optimism (or least pessimism) for 2009, according to Kermit Baker, economist for the American Institute of Architects. He points out that the extended period of low construction has helped reduce the inventory of houses for sale, a precondition to the resumption of housing appreciation. Baker offers one catch though:

"The number of vacant homes for sale went from 2.277 million in the first quarter of 2008 to 1.916 million in July 2009, a significant reduction in the inventory," he said. "The unknown factor is the number of homes that have been off the market waiting to go up for sale when things improve. An unexpected increase in inventory would keep housing prices from rising again."

Baker also sees a trend emerging from the housing bubble that will influence the future on residential construction. "AIA surveys residential architects each year about their business. The AIA Home Design Trend Survey for 2009 confirms a couple of interesting trends," Baker revealed. "First is that the home size is getting smaller again. Architects reported that 42% of their clients were building bigger homes in 2005, but only 4% in 2009. During the same time, 13% of clients were building smaller in 2005 but 50% were downsizing in 2009. While homes are getting smaller energy efficiency and aging accommodation features are growing in use, even when including them in the design adds to the cost."

Baker's conclusion is that the combination of the demographic shift and the economic impact of the 2008 market crash have altered the face of the housing market for the near term, requiring less home with more accommodations for accessibility and efficiency.

The AIA also provides one of the better trend indicators for the coming health of the construction industry. Kermit Baker developed the Architectural Billing Index to measure the relative health of the member firms' business now and in coming months. The survey asks each month whether members' billings and inquiries are higher or lower than the previous month. A score of 50 indicates flat performance. Since design tends to lead construction by six to twelve months, and improving ABI, especially one over 50, is a positive sign for contracting. Unfortunately, the current ABI offers uneven indications about 2010.



"September is 43.1, which is much better than the January index of 33.3; however, in absolute terms it's not an indication of real improvement," explains Baker. "The best news is that the index for inquiries remains above 50 (September was 59) going back to February. But even that data may not be entirely positive, since the recession has spurred increased marketing activity among AIA firms, and the higher inquiry index could be an indication of more architects pursuing the same amount of work."

Declining commercial property values, recessionary pressures on consumer demand and business growth, tepid housing recovery and lingering credit problems all are weighing on the forecasts for 2010. Getting four economists to agree on the market is unusual, but their scenarios may have the best analogy in battlefield terms: 2009 marked the retreat, and 2010 will be a time of retrenching and reclaiming earlier positions. None seem to expect a charge again until another year has passed.

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