



Construction National Outlook: September/October 2010

"Uncertainty reins."

That's how Real Estate Roundtable (www.rer.org) president and CEO Jeffrey DeBoer introduced RER's second quarter real estate executives' survey on August 6.

Whether you are referring to commercial real estate, as DeBoer was, or commenting on the overall global economy the sentiment sums up more definitively in two words what the entire financial press has been babbling about since the first quarter. While there are an entire battery of data and categories to illustrate and analyze what the status of the economy is at the moment, the next trend in direction seems to rest on one metric: jobs.

Over the duration of a full business cycle there are always short stretches of time when the markets seem to flatten out, when data suggests a marking of time rather than the continuance of a trend. We find ourselves in such a time in summer 2010. Here is a sampling of the information that reflects the current uncertainty.

Let's start with the RER survey. Its upbeat note was that the preponderance of real estate executives responded that commercial property values had stopped falling in their markets for the second straight quarter. This almost certainly confirms that the precipitous decline in value of over 50% during the past two years has ended. At the same time, the same executives expressed doubt that property values were going to rise in the foreseeable future.

Another survey that has historically been a solid leading indicator is the American Institute of Architect's Billing Index (ABI). The index measures the responses to whether the surveyed firms' billings are rising or falling in that month. A score of 50 indicates as many rising as falling and obviously scores above 50 indicate growing future opportunities. The July ABI of 47.9 was slightly higher than June's 46 response, but it marked the 30th consecutive month below 50. Moreover, it marked another month of responses between 45 and 50, confirming that design activity has picked up over the past year but also that activity is also anemic. Even the relatively positive reading on inquiries, up to 53.1, may only be reflecting an increase in the number of firms asked to compete for commissions rather than an uptick in projects in the pipeline.

The government's Bureau of Economic Analysis reported that second quarter gross domestic product grew 2.4%, a significant decline in growth from the first quarter's 3.7% GDP growth. At the same time the BEA reported that investment in residential and non-residential structures increased at a healthy pace, 5.2% and 27.9% respectively, in sharp contrast to the first quarter declines of 17.8% and 12.3%.

In its data BEA found that the personal savings rate rose to 6.2%, the most since 1998. Real disposable income rose 4.4%. Business investments rose at a 17% annual rate in the second quarter after a 7.8% gain in the first quarter. Investments in equipment and software rose at a 21.9% pace. Business fixed investment added 1.5 percentage points to growth. Inventories increased by \$75.7 billion. The change in inventories added 1.1 percentage points to growth.

Yet all of the signs that the economic decline has ended have not coincided with a related increase in construction; in fact the opposite has occurred. According to Reed Construction Data the value of nonresidential starts in July was 9% lower than that of July 2009, with nonresidential building activity falling 14%. Construction in those categories has been up so far this year, with nonresidential building rising 5% year-to-date and heavy construction up 12%, but construction volume that remains below 2009 is still uneven at best.

Residential construction remains mired in aftermath of the mortgage bubble implosion that is now three years old. Housing starts for July were reported on August 17 at levels that are below last year's. Permits for new homes in July were at a seasonally adjusted annual rate of 565,000 units, a 3.7% decline from July 2009. Housing starts declined 7% from the July 2009 rate of 587,000, to a seasonally adjusted annual rate of 546,000. The National Association of Realtors reported in August that the median price of single-family existing homes nationally in the second quarter was up 1.5 percent from the second quarter of 2009, but at the same time acknowledged that little of their data shed light on when the inventory of foreclosed homes would cease to be a drag on prices.

One segment of the housing market that has begun to show life is multi-family. The sharp decline of single-family home values and the slowdown in the economy should have been driving vacancy rates for apartments down throughout the past 18 months, yet that market remained soft in 2009. Demand for apartments has risen significantly this year, said Greg Willett, vice president of research and analysis for MPF Research, which analyzes apartment trends. "There's no way to look at these apartment numbers and not be impressed," he said.

June vacancy rates in the largest 64 markets in the country averaged 6.6%, down from 8.2% at the end of 2009, according to MPF Research. The apartment market absorbed 215,000 units in the first half of the year, and at this rate, the market will absorb a little more than 300,000 units by the end of 2010, according to data released Aug. 6. Absorption is the net change in the number of units physically occupied. That rate would surpass the net absorption of just under 300,000 units in 1999, 2000 and 2004, which were the highest rates since 1990. Big changes in net absorption have historically been accompanied by growth in employment, since more jobs create more opportunities for those who are entering the workplace to afford an apartment. The significant spike in foreclosures over the past few years has also created a pool of potential renters and it will be some time still before it is known how much of the rise in apartment demand is simply a result of displaced homeowners finding a place to live.

As summer winds down there is not much evidence that any positive trend in employment is building. Mid-August Department of Labor reports showed a surprising increase in layoffs had occurred. First time filings for unemployment

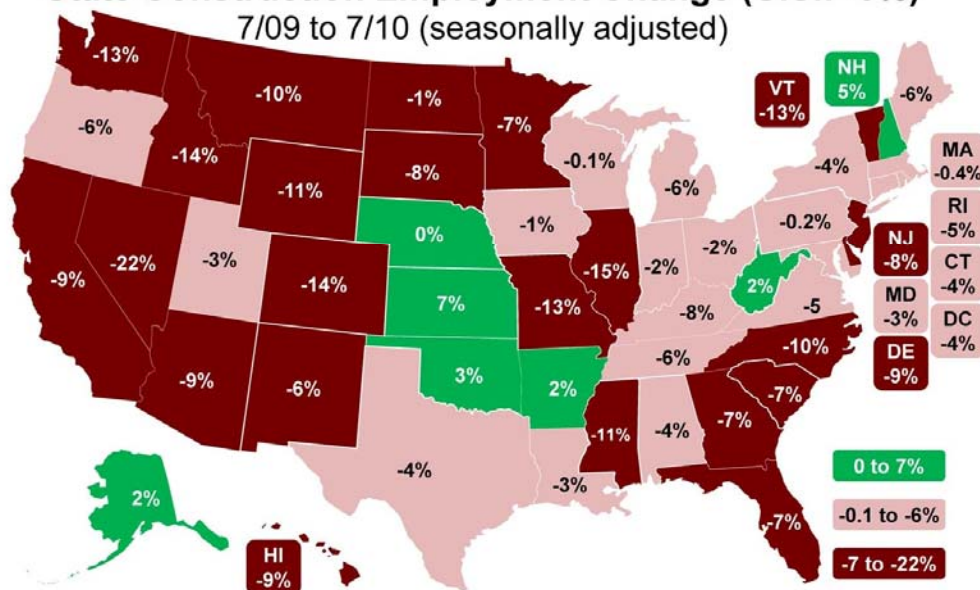
compensation were slightly higher after declining for most of the year. Private sector job creation was positive, but at less than 200,000 per month the pace was insufficient to put a dent in the 8 million jobs lost.

Construction unemployment had moderated by July. Those laid off rose by 11,000 in July but construction unemployment fell to 17.3% compared to the 18.2% of July 2009, representing a year-over-year gain of 150,000 jobs. Employment fell to a seasonally adjusted total of 5,573,000 workers, a 14-year low. When distributed by state, construction employment shows a handful of state with actual increases in employment, and many more states with mild decline. As has been true throughout the recession, the overall high unemployment has been exaggerated by dreadful conditions in a small number of states, primarily California, Michigan, Arizona, Florida and Nevada.

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State Construction Employment Change (U.S.: -6%) 7/09 to 7/10 (seasonally adjusted)



Source: BLS state and regional employment report

The highest rates of construction unemployment remain concentrated in a handful of states.

At the end of the day no amount of analysis of the second quarter macroeconomic or construction data changes the conclusion that real change is dependent upon a change in unemployment. It seems unlikely that the economy will experience a pullback that drives unemployment back above 10%, but the fear of a 'double dip' lingers enough that employers aren't hiring in great numbers. The stock market has regained 70% of its October 2007 high yet it remains exceptionally sensitive to employment reports. The next big move in employment will surely dictate the direction of the markets and construction, for better or worse.

