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## Construction National Outlook: August 2010

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Like the national economy the construction industry at mid-year is at a stage of moving somewhat laterally, trying to find a direction. Instead of having a clearer sense of the industry's health, there remains uncertainty about several key factors in the direction and trend for 2011.

At the end of June the indicators of the health of the housing market were weakening. Always an indicator of the economy's direction, the housing market is even more important to the strength of this cycle's recovery than in previous cycles. Two key measurements – the sales of existing homes and the sales of new homes in May – were being anxiously anticipated to gauge how much of the early recovery in housing was sustainable once the \$8,000 tax credit program expired. The provisions of the program required a contract by signed by April 30 so May's volume would be the first in eight months to show sales without the extra incentive.

The results were negative as expected; however, the degree to which the volume was seen as negative seemed to depend on how high your expectations were.

First, the results. Sales of single-family units, which are completed transactions that include single-family, townhomes, condominiums and co-ops, were at a seasonally adjusted annual rate of 5.66 million units in May, down 2.2 percent from an upwardly revised surge of 5.79 million units in April. May closings are 19.2 percent above the 4.75 million-unit level in May 2009. The decline from April seemed to catch many observers off guard, but NAR chief economist, Lawrence Yun sees the volume in May as elevated.

Yun said he expects one more month of elevated home sales. "We are witnessing the ongoing effects of the home buyer tax credit, which we'll also see in June real estate closings," he said. "However, approximately 180,000 home buyers who signed a contract in good faith to receive the tax credit may not be able to finalize by the end of June due to delays in the mortgage process, particularly for short sales.

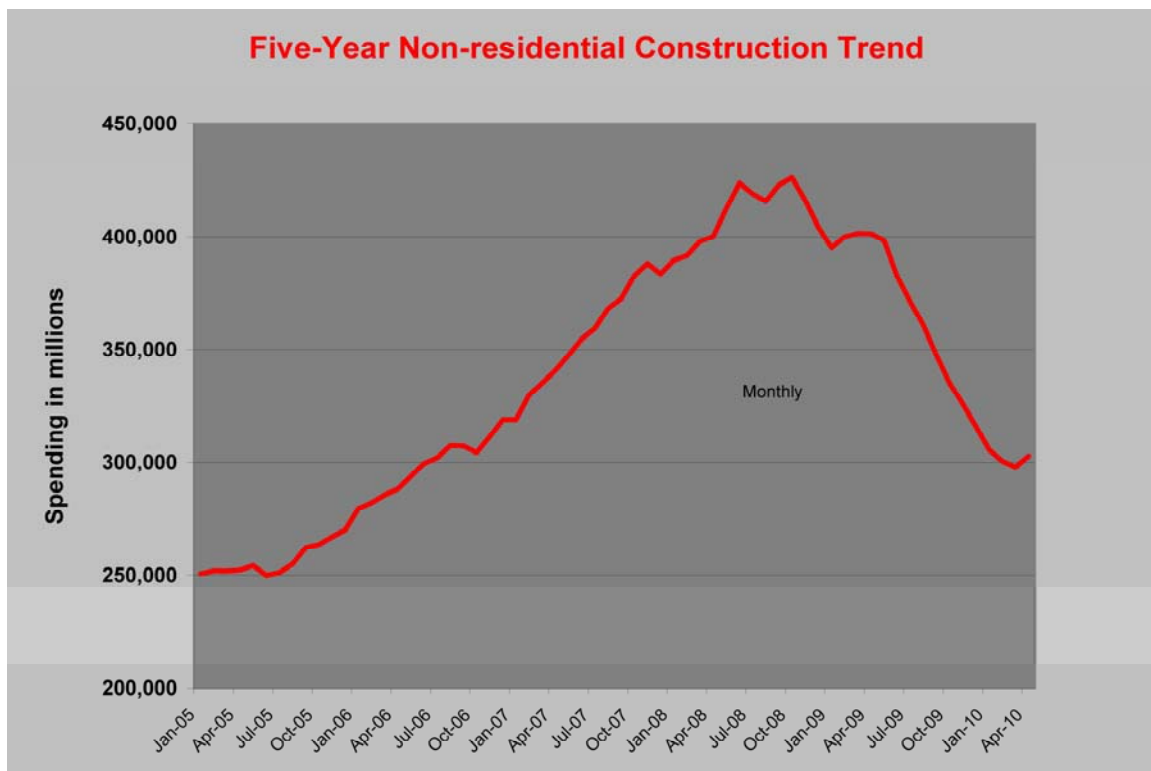
Sales of new single-family homes plunged 33% in May to a record-low level after a federal subsidy for home buyers expired, according to data released June 23 by the Commerce Department. The magnitude of the decline seemed to catch markets by surprise initially.

Builders, on the other hand seemed to have been expecting a steep decline as the 10% decline in May home starts reflect. Home builders continued to shed inventories in May, cutting the number of unsold homes by 0.5% to 213,000, the lowest level in 39 years. In the past year, inventories are down 27%, while sales are down 18%.

Total housing inventory at the end of May fell 3.4 percent to 3.89 million existing homes available for sale, which represents an 8.3-month supply at the current sales pace, compared with an 8.4-month supply in April. Raw unsold inventory is 1.1 percent above a year ago, but is still 14.9 percent below the record of 4.58 million in July 2008. The reduction in inventories has helped keep prices appreciating slightly, but the number of new foreclosures is still keeping supply from being eroded fast enough to improve the appreciation picture for the next twelve months or so.

The national median existing-home price for all housing types was \$179,600 in May, up 2.7 percent from May 2009. Distressed homes slipped to 31 percent of sales last month, compared with 33 percent in April; it was also 33 percent in May 2009.

Activity in the non-residential sector has been turning positive for the past 60 days, albeit at volumes that are well below historical norms. The Commerce Department's reports showed nonresidential contracting increasing in April for the first time since March 2009, rising above the \$300 million level again.



*The trend in nonresidential contracting has reversed in late spring after an 18-month decline of more than \$125 billion. Source, Dept. of Commerce*

Reed Construction Data announced on June 17 that the value of new nonresidential construction starts in January-May 2010 combined was 9.8% higher than in the same months of 2009, based on data it compiled. May starts were 16% higher than in April, not seasonally adjusted, "a little more than the usual seasonal gain," Reed Chief Economist Jim Haughey said. "The value of starts has now been about steady for three months after allowing for seasonality. Current starts are 50% above the low point last June but remain 25% below the pre-recession peak."

Haughey noted that commercial property starts jumped 52% from an unusually weak April but remain more depressed than institutional starts. There was a significant May rebound in all commercial categories except hotels, which slipped a further 40%.

Commercial real estate categories was on CB Richard Ellis senior economist Arthur Jones' mind when he addressed the CBRE real estate symposium at the 501 Grant Street Building on May 18. Jones outlook for the commercial market is for a more stagnant 'U' shaped recovery.

His forecast for the capital markets reflected that same viewpoint, counting on the global surplus of capital and the higher savings rates to keep U. S. Treasury rates below five percent for the near futures Jones also presented data that showed that the decline in new construction was preventing inventory growth and keeping capitalization rates from going higher, as was predicted by most economists. CBRE Econometrics is forecasting a decline in cap rates after a peak in the first quarter for office and industrial properties. Jones sees cap rates on offices falling to 7.5 by the fourth quarter of 2010, but cautioned that some of the support for current property values was a result of lenders holding off write-downs. Any change in the regulatory environment or a shift in sentiment that would accelerate the acknowledgement of lower values could cause a spike in cap rates.

CBRE's data on the national retail sector showed just how deeply the recession has dampened consumer spending. Since the start of the recession more than 12,000 stores have closed. Approximately 2,200 anchor retailers have closed, leaving more than 69 million square feet vacant and 200 million available junior anchor space (stores over 20,000 square feet in size).

**Vacancy and Availability Rates**

	2010Q1	Peak/Year	Previous Peak Year	"Natural Rate"	Year Back to "Natural Rate"
<b>Office</b>	16.6	17.6 / 2011	19.0 / 1992	13 to 14	2014
<b>Industrial</b>	14.0	14.3 / 2010	11.8 / 2004	9 to 10	2016
<b>Retail</b>	12.8	12.9 / 2010	11.3 / 1991	9 to 10	2016
<b>Multifamily</b>	6.5	7.4 / 2009	6.8 / 2003	5 to 6	2011
<b>Hotels</b>	41.4	44.5 / 2009	41.6 / 2003	35 to 37	2012

*The outlook for commercial real estate recovery is mixed over the next few years.  
Source CBRE Econometrics.*

Because of the dislocated way this real estate recession began it appears more likely that the recovery of the commercial market will be staggered. Using historical normal rates of vacancy as benchmarks, the recovery that is underway in commercial real estate will require as more than five years to play out in the retail and industrial sectors, with office buildings needing another three to four years and hotels normalizing in 2012. Only in the least commercial type of property, multi-family housing is a return to normal vacancy rates foreseen in 2011.

One potential opportunity for the market is in the non-building sector. As the ARRA spending ends later this year several factors are aligning that may give legs to the concept of another stimulus program.

Two very pressing realities are the accelerating decline in the condition of the nation's infrastructure and the inability of the states to pay for the improvements. The existing mechanism for funding, the various surface transportation acts from the federal government has risen much less than the cost of construction and is increasingly inadequate to keep up with failing bridges and highways. A third factor that could tip the scales is the possibility that the stagnating recovery (or non-recovery) could cause a second rise in unemployment later this summer. That would be very bad timing for nervous members of Congress, who are already feeling the re-election heat.

Another stimulus package aimed at rebuilding highways and infrastructure would create more debate about the long-term impact on national debt, but it would also get directly to where the politicians would be aiming: more jobs faster.