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Construction Outlook 2013: Positive Forecast Encourages Optimism For Real Estate Industry

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With the Presidential election behind us, a temporary respite from the fiscal cliff, and the accelerated interest of the capital markets in real estate investment, the construction industry is moving forward into 2013 in anticipation of modest growth and expansion.

As noted in the recently released McGraw-Hill Construction Report, "total U.S. construction starts for 2013 will rise 6% to $483.7 billion, slightly higher than the 5% increase to $458 billion that was estimated in 2012." Robert Murray, Vice President of Economic Affairs for McGraw-Hill cites low interest rates and improving market fundamentals as among the factors that will help bolster the construction market in the coming year.

The report continues to advance encouraging news for 2013. Several key predictions for the major construction markets noted in the report include:

• 24% increase in dollars and a 21% increase in units for single-family housing

• 16% increase in dollars and a 14% increase in units for multi-family housing

• 12% increase in commercial building up noticeably from the 5% increase in 2012

• 13% drop in institutional construction due to reductions in higher education and healthcare spending

The large increase in single-family housing volumes anticipated in 2013 predicts that more Americans will be buying and building homes in the upcoming 12 months at four times the rate since 2006. Consumers willing to enter the housing market following such a long hiatus is looked upon as a sign that the economy and the entire construction industry is returning to levels of normalcy that we have not experienced for over half a decade. In fact, the National Association of Home Builders is forecasting a 19% increase in total housing starts for 2013 that would equate to approximately 903,000 units.

NAHB's Chief Economist Dave Crowe's also stated that the multi-family residential sector is well on its way to recovery being more than two-thirds of the way back to its normal levels of new construction starts. Many industry experts have stated that the multi-family market could be the strongest of any construction segment in 2013.

ENR also anticipates the percentage increase in commercial building construction to double from 2012 levels raising the projected 2013 increase to 12%. New construction of hotels, offices and warehouse/distribution facilities may not fuel the majority of this growth but expansive upgrades and modernization programs of those product types will bolster the growth in the commercial market segment. The manufacturing sector is also likely to contribute to the increase in construction starts in 2013 with an anticipated volume of $12 billion in new starts this year, rising 8% above last year's numbers.

The Associated General Contractors Chief Economist, Ken Simonson, originally anticipated that last year's growth in overall construction spending would rise from 5% to 9% with actual volume growth settling in at about 6%. "Not great, given that we had a 37% drop from peak to trough," he says, "But it's the first increase (in total construction spending) in six years." He continues, "Although all major spending categories are far below pre-

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Construction Cost Outlook

Due to the slow market conditions in both the residential and commercial markets, inflation has been held in check over the past four years. Engineering News-Record, a leading publication that tracks activity within the U.S. construction market, is forecasting an overall modest 1.0% construction price increase in 2013 as cited in its Construction Cost Index. The increase is far less than the 2.6% increase experienced in 2012.

Stronger than expected housing activity in 2012 pushed lumber prices up 5.5% as compared to the 3.5% increase that was originally anticipated. However, due to a weaker demand than originally projected, steel prices declined 0.8% in 2012 as compared to 2011. Heading into 2013, ENR projects that lumber prices will rise 7.3% with steel falling prices dropping by 6.7%.

Using an average weighted index to compute union wage contracts, ENR anticipates a 2.3% rise in skilled-labor and 2.0% increase for non-union labor costs for 2013.

It's also predicted that concrete reinforcing bar (rebar) will drop 10.4% in 2013 due to the continually softening of steel prices. However, 2014 is a year that is expected to witness rebar pricing's full recovery.

Cement prices are anticipated to rise 1.1% in 2013 as noted by ENR. The forecast projected by Global Insights is for cement to increase 1.3% this year following on the heels of the 0.8% increase of 2012.

In Closing

While 2013 is not anticipated to challenge the record-breaking volume set in 2007, the construction forecast for 2013 should follow the positive momentum brought forward by:

- Congress tax and budgetary policies
- European stability
- Nuclear power construction
- Clean and renewal energy projects
- Improvements in research and development areas
- Transportation improvements
- Advances in healthcare and medical technologies
- Automotive industries

Looking ahead, AGC's Simonson summarized his outlook for 2014 – 2017 to include an uptick of 6% to 10% in total construction spending each of those years with less square footage being delivered in housing and retail and a reduction in public spending. New drivers that will propel construction during that same timeframe include shale-based oil and gas production; the increase in activity due to the widening of the Panama Canal; and additional construction to support the needs of the elderly and children rather than young adults.

As we avoided the possibility of reverting into recession in 2012, the outlook remains tepidly optimistic that 2013 will propel us even further from the edge of yet another challenging economic crisis.

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through 2013 and finally dip back below 7% unemployment in 2014.

In Chicago, employment is actually up 3.2% since October 2009, according to the Chicago Fed's Mattoon. Even though construction job growth sagged by 20% over that period, jobs in the larger manufacturing sector surged more than 16% to effectively erase the deficit. Overall, Mattoon cited these statistics reported by World Business Chicago:

The Chicago area economy has added 29,000 jobs since October 2011, led by large gains in the professional and business services (+23,800), manufacturing (+13,000), and leisure and hospitality (+10,700) industries. During this period, the Chicago region added more manufacturing jobs than any other metro in the nation.

- **Midwest housing starts rose for the fourth consecutive month to 153,000 in October,** an increase of 6,000 over September and up 39% over last year.
- **The Consumer Confidence Index improved to 73.1,** an increase of 4.7 points over September and the highest level since the beginning of the recession.
- **The Architecture Billings Index,** a forward looking indicator of nonresidential construction spending, climbed for the third consecutive month to 52.8, reaching its highest level in nearly three years.

Fiscal Cliff-On-The-Prairie

Despite those upward trends, Mattoon said he worries that Illinois may face its own "fiscal cliff" in 2015. "We are broke," he told CoreNet Chicago. Increases in personal and corporate income taxes so far have not made a dent in the state's pension liability or even its unpaid bills. In December, Moody's gave Illinois a negative A2 rating for its credit, the worst in the nation. "If nothing changes," he added, "the state will need to contribute $6.87 billion in FY14 and by 2016, the state will be spending more on pensions than on K-12 education.

If Gov. Quinn and the state legislature can somehow reach a deal on pensions later this year and President Obama and Congress can find a similar path to addressing the national debt, these economic forecasts may finally come into sharper focus. Until then, however, it may be best to find something sturdy to hold onto.

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recession highs, they are well above their recent low points."

Simonson also predicts a very gradual upward trend for 2013. He anticipates a slow return to high single-digit increases in construction spending through 2017 as the nation's economy and population continues to grow.

He forecasts that the multi-family housing boom will continue in 2013 citing vacancy rates at a 10-year low and continued escalating rental rates. His positive outlook on the entire residential market is bolstered by the sector's increased spending which has grown by 49%.

An uptick in power and energy construction due to recent shale oil and natural gas exploration and development will also contribute to growth. Simonson notes that U.S. shale production rose 67% from 2007 to 2010 and the current work underway will not be completed for years to come.

Simonson's outlook on the positive impact of the Panama Canal expansion includes new port dredging initiatives, the construction of piers, installation of larger and additional crane systems, land access roadways and bridges, and a notable increase in the construction of warehouse and transportation facilities. The Panama Canal expansion is anticipated to result in a sizable 23.5% increase in spending on U.S. ports and waterways in 2013.

Simonson notes that public construction has contributed the least to overall construction spending since late 2010 and it continues to decline at a rate of 3% annually as projected for 2013.

FMI Corp., Inc. is predicting growth in 2012 to be close to 7%. "Overall, we expect to see continued slow growth and recovery and ongoing change within the industry via technology, consolidation, and the search to find more viable funding for the increasing backlog of postponed projects and damaged infrastructure that so urgently needs attention," reads the firm's 2013 U.S. Market Construction Overview report. Landon Furstein, managing director of FMI, projects increases in residential, non-residential and non-building (infrastructure) with a sizable 25% to 30% increase in multi-family housing starts. He also anticipates that the Affordable Care Act will generate new construction within the healthcare industry citing the need for additional facilities and the modernization and technological update of existing hospitals and healthcare buildings.

Members of the Associated Builders and Contractors (ABC) cite that much of the construction taking place in 2013 and beyond will be financed privately since publicly-financed projects are anticipated to be flat or experience a slight decline. Industries that are often buoyed by private financing investment include office-related construction, commercial properties, lodging, healthcare and manufacturing. The ABC forecasts that many investors will opt to invest in hard assets as a way to avoid possible volatility as experienced within the equity and bond markets. ABC experts anticipate that total construction will grow about 10% in 2013 with growth in lodging and healthcare set to rise 8 and 5 percent, respectively.

Reed Construction Data, another well-respected organization that tracks and projects construction activity recently advanced the following:

"We won't fall off the fiscal cliff." Even though the ordeal will create unnecessary uncertainty for the next three to four months, it is not anticipated that the U.S. will experience the negative fallout from an unresolved financial doctrine.

"Residential, Commercial and Institutional forecasts are moving in a positive direction." In fact the U.S. may reach the creation of one million new household formations this year. Although the residential markets are responsible for the positive outlook, the commercial and industrial segments are poised to attain similar growth in 2013.

Reed's chief economist, Bernard Markstein also stated that education, power generation and highway construction will continue to be important contributors of non-residential spending. He states that Reed Construction's outlook is "very positive on manufacturing spending in 2013 and 2014," citing the resumption of delayed spending, reshoring and much lower natural gas prices as contributing to the rebound.

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