

Economics

Nonresidential Construction Projected to Eke out Modest Gain *AIA Consensus Forecast Panel bullish on institutional, bearish on commercial*

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Although a business slowdown has set in, it appears that the construction sector will not bear the brunt of it. The AIA Consensus Construction Forecast Panel is projecting modest growth in nonresidential construction activity for 2001 and more of the same throughout 2002. Four panelists expect growth this year, while three are anticipating declines. For next year, five members of the panel are projecting gains in nonresidential construction activity.

Nonresidential construction is being dragged down by a weak commercial sector, particularly for retail and hotel space. The industrial sector is expected to be strong this year before flattening in 2002. The institutional sector is expected to be solid this year and next, owing to anticipated gains in education construction. A strong institutional sector bodes well for architects, because half of billings at firms come from institutional buildings.

Overall economy slowing

Since early last summer, there have been signs that the overall economy has been weakening. However, it didn't become clear until late last year just how vulnerable our economy was to a recession. The Fed has responded by aggressively pushing down short-term interest rates since the beginning of the year. While the manufacturing sector is declining, consumer confidence levels are uncomfortably low, and inflation is reemerging as a more serious threat, the hope remains that the U.S. can avoid an economywide

recession.

The construction sector, however, has fared much better than most other sectors of the economy during this slowdown. The performance of the housing sector has been nothing short of amazing. Through the first quarter of this year, homebuilding was running at a pace in excess of 1.6 million starts at an annualized rate, very close to its high-water mark over the past decade.

The overall construction sector has been lifted by the healthy residential sector. For example, while employment in the overall economy increased less than 0.5% between April 2000 and April 2001, construction employment grew by 2.2%. Spending on the construction of nonresidential buildings grew by almost 7% during the first quarter of this year after adjusting for inflation, while the economy grew by only 2%.

Commercial sector following the broader economy

Commercial construction is the nonresidential sector most impacted by national economic trends, so it is no surprise that this sector is currently the most vulnerable. Our forecast panel is predicting a modest decline in commercial construction activity this year and modest growth in 2002. The retail and hotel sectors appear to be particularly vulnerable, with most members of the panel anticipating a downturn in these two sectors this year and only a very modest recovery next year.

Even the office construction market—the sector that has the greatest potential for shoring up the commercial sector this year and next—is facing some serious challenges. Office vacancy rates nationally climbed from 8.3% at the end of last year to 9.5% as of the end of the first quar-

ter of 2001 according to data from Torto Wheaton Research. Areas with the greatest increase in office vacancies over this period: San Francisco (+3.5%); San Jose (+3.3%); Seattle (+3.3%); Austin (+3.1%); Oakland (+2.9%); Phoenix (+2.7%); and Washington, D.C. (+2.7%) are areas that by-and-large have a strong technology component to their employment base.

Even with rising vacancy rates, most metro areas were still seeing rising rents and growing absorption of office space, according to information from Oncor International. Twelve North American markets absorbed 5 million square feet or more of office space during 2000, paced by 13.7 million square feet in the Chicago metro area, 7.3 million in Silicon Valley, and 7.2 million in Tampa/St. Petersburg. So even if the office market does not see much growth in construction this year or next, it still is operating at its highest levels of activity in over a decade.

Industrial construction strong but easing

Given that the manufacturing sector is largely responsible for dragging down the rest of our economy, it's surprising that industrial construction is projected as the strongest construction sector this year. Industrial facilities, along with educational buildings, are the only sectors to get a unanimous thumbs-up from our forecast panel for this year. After years of strong economic growth, national availability rates for industrial facilities are at their lowest levels in more than a decade. Rents in this sector increased by more than 11% last year according to Torto Wheaton Research. These strong fundamentals are carrying over into strong construction activity this year, although our panel projects a significant slowing

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of growth in 2001.

Institutional activity stable

Institutional construction activity is expected to exhibit its traditional stability through the remainder of next year. Institutional construction activity historically has shown a less volatile pattern than the commercial and industrial sectors. The consensus among our panel members is for gains to be in the 2.5% to 3.0% range through 2002.

Health-care construction is one sector that is expected to remain fairly weak. All members of our panel are predicting at least some decline in health-care construction this year. A continuation of cost containment efforts that have been in place for several years now are the main reason for weak growth. The federal government has made a

concerted effort to control Medicare expenditures, which has reduced the need for many types of health-care facilities. Additionally, managed-care organizations have been dealing with a profit squeeze, which has restricted their capital expansion plans.

However, cost containment in the health-care sector seems to have just about run its course. Several types of health facilities—assisted living programs and community-oriented health centers among them—are seeing increased popularity, which should help prop up some of the weakness in regional medical facilities. Most of our forecast panelists expect modest gains in health-care construction next year.

Educational construction has been one of the most consistent performers over the past decade. Strong growth in enrollments coupled with healthy revenue gains by state and local govern-

ments have generated consistent gains in educational construction. All members of our forecast panel expect further growth this year, but the consensus is for slower growth next year as slower economic growth takes its toll on the local tax base for financing school construction.

Public construction, a category that encompasses government offices, criminal justice facilities, courts, and post office facilities, obviously is very dependent on government funding programs.

There has been a dramatic need for additional detention space in recent years, and the federal government has embarked on a major program to add and upgrade courthouse facilities. Although funding for these programs can vary tremendously from one year to the next, our panel foresees stable growth in this sector for the next two years. ■

AIA CONSENSUS CONSTRUCTION FORECAST PANEL—SECOND HALF, 2001

	F.W. Dodge Bob Murray (781) 860-6623 Contract Awards (billions of 1996\$)		Cohners Economics Daryl Delano (617) 630-2115 Spending PuHrPlace (billions of 1996\$)		NAHB Stanley Duobinis (202) 822-0237 Spending PuHrPlace (billions of 1996\$) (private structures only)		WEFA Group Jim Diffley (610) 490-2642 Spending PuHrPlace (billions of 1996\$) (private structures only)		Portland Cement Assoc. Bill Toel (847) 966-6200 Spending PuHrPlace (billions of 1996\$) (private structures only)		Economy.com Mark Zandi (610) 696-8700 Spending PuHrPlace (billions of 1996\$) (private structures only)		FMI Tom Loy (919) 785-9267 Spending PuHrPlace (billions of 1996\$)		Consensus	
	Actual 2000 \$	Forecast 2001 2002 % change	Actual 2000 \$	Forecast 2001 2002 % change	Actual 2000 \$	Forecast 2001 2002 % change	Actual 2000 \$	Forecast 2001 2002 % change	Actual 2000 \$	Forecast 2001 2002 % change	Actual 2000 \$	Forecast 2001 2002 % change	Actual 2000 \$	Forecast 2001 2002 % change	Forecast 2001 2002 % change	
Nonres. Total	161.4	-3.8 -2.8	261.0	-0.4 2.6	187.1	2.4 1.3	186.4	2.0 0.0	186.3	-0.4 0.9	186.4	4.5 3.0	256.5	3.0 3.0	1.0 1.1	
Commercial Total	79.0	-7.5 -6.2	112.5	-3.7 3.2	112.9	0.4 4.6	112.7	2.0 -0.1	112.5	-1.4 -0.6	112.7	3.9 2.0	108.8	3.0 2.0	-0.5 0.7	
• Office	31.0	-7.1 -10.1	46.4	2.7 6.1	46.2	3.9 6.3	46.3	4.0 -1.0	46.4	0.2 2.2	46.3	7.8 3.2	49.9	7.0 4.0	2.6 1.5	
• Retail	20.0	-9.5 -2.2	*52.2	*-7.7 *1.1	*52.7	*-1.3 *2.7	*52.4	*0.0 *1.0	*52.2	*-3.3 *-1.4	*52.4	*1.5 *0.8	35.6	-1.0 1.0	-3.0 0.4	
• Hotel	7.0	-1.4 4.3	13.9	-9.8 0.6	14.0	-5.0 6.0	14.0	0.1 -0.1	13.9	-10.3 -8.0	14.0	0.0 2.9	13.4	-2.0 -2.0	-4.1 0.5	
Industrial Total	8.6	3.5 9.0	34.7	1.5 -0.7	34.8	8.3 -10.9	34.7	10.7 -0.5	34.7	0.8 4.3	34.7	8.4 1.1	*47.6	*2.0 *2.0	5.0 0.6	
Institutional Total	73.7	-0.7 -1.1	113.7	2.2 3.1	*39.3	*3.3 *3.2	n/a	n/a n/a	n/a	n/a n/a	n/a	n/a n/a	73.4	*5.0 *6.0	2.5 2.8	
• Health	12.1	-4.1 -0.9	16.8	-1.7 2.0	n/a	n/a n/a	*13.2	*-3.0 *1.0	*13.2	*-1.5 *3.8	n/a	n/a n/a	15.8	-1.0 0.0	-2.3 1.2	
• Education	33.2	2.1 -1.5	50.0	5.1 6.6	n/a	n/a n/a	*10.1	*5.0 *0.0	*10.1	*6.7 *1.9	n/a	n/a n/a	49.0	9.0 9.0	5.6 3.2	
• Public	6.6	3.0 2.9	n/a	n/a n/a	n/a	n/a n/a	n/a	n/a n/a	n/a	n/a n/a	n/a	n/a n/a	n/a	n/a n/a	3.0 2.9	

(* includes other commercial buildings) (° private construction only) (° includes public industrial) (°° includes health, educational, religious buildings)