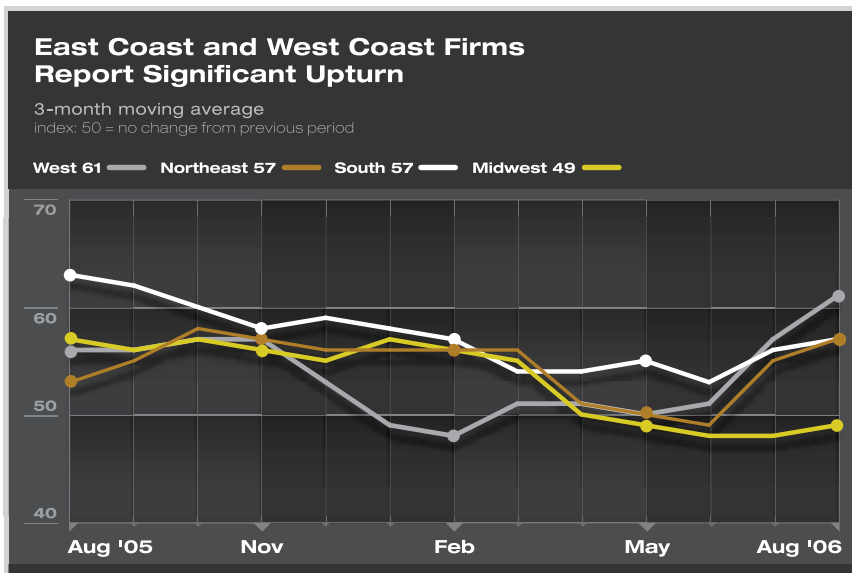


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Firms Enjoy a Late Summer Surge

As nonresidential activity heats up, firms report change orders on the rise



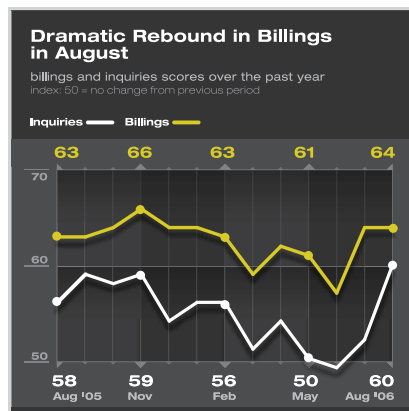
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Regionally, firms in the West have reported the greatest improvement in business conditions in recent months. In August, their index reading was well above that of any other region. Firms in the Northeast also report very strong conditions, while firms in the Midwest reported their fifth straight decline in billings. Inquiries for new work continued to be positive in August, showing strong interest for new projects.

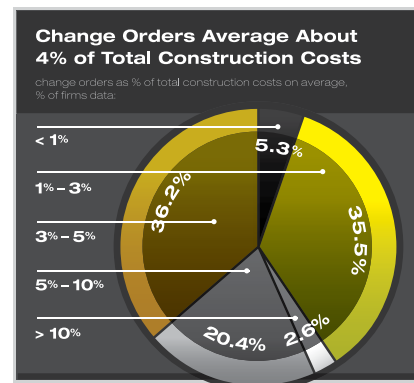
Broader economy is slowing down

The broader economy remains healthy, but is showing signs of slowing. Business payrolls increased 128,000 in August. A rule of thumb is that payrolls need to increase by around 150,000 nationally to absorb new job seekers, and August was the fifth straight month that payroll gains were below this level.

Homebuilding is in the midst of a substantial slowdown. Housing starts totaled 1.67 million in August at a seasonally adjusted annualized rate, their lowest level since early 2003. So far, housing starts have declined six of this year's eight months, with August figures almost 24 percent below levels of a year ago. Single-family starts are down more than 25 percent from a year ago.



A slower-growing economy has helped ease inflation in consumer prices. Price increases have begun to moderate in recent months, with lower inflation rates likely to continue with the recent drop in gasoline prices. Falling gasoline prices seem to have improved the spirit of consumers. The University of Michigan Consumer Sentiment Index moved up for only the third time this year with the early September reading.



Change orders becoming more common

As construction activity strengthens, project-specifications change orders often increase. Our Work-on-the-Boards panel reported increasing change orders recently, as well over a third (37.5 percent) of firms responded that change orders have become a lot more common or somewhat more common in recent years. Fewer than 6 percent of firms feel that they have become less common recently.

Architecture firms report that change orders average about 4 percent of total construction costs, with 23 percent of firms estimating that change orders average 5 percent or more of total costs. Change orders tend to run

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somewhat higher in the residential sector, as over a third (34.8 percent) of residential architects report that change orders average 5 percent or more of their projects and average 5.2 percent on projects for firms specializing in this sector. Institutional firms report the lowest project change orders (3.8 percent of construction costs on average), just below commercial/industrial firms (4.0 percent).

There is also considerable regional difference in the prevalence of change orders. Firms in the Northeast report that change orders average 5.1 percent of construction costs, while firms in the Midwest report much lower averages at 2.9 percent.

Change orders result for many reasons. Architecture firms report that owner requests and changes in the scope of a project account for more than half of the average increase in costs on a dollar basis. Unknown or unforeseen circumstances account for about a quarter of the value of change orders. A/E errors and omissions and regulatory-agency-required changes each account for about 10 percent of change orders on a dollar basis.

Reference:

This month, Work-on-the-Boards participants are saying:

- Local markets are stable for us. International markets are growing as fast as we can cope.
— *73-person firm in the Northeast, commercial/industrial specialization*
- We currently have a lot of projects lined up, but they are extremely slow in starting. We need to hire more staff, but are having difficulties finding qualified individuals.
— *12-person firm in the West, mixed specialization*
- Homeland Security projects are very active. Anti-Terror/Force Protection projects (provides security planning for defense agencies) are large in scope and technology which translates to high costs per square foot.
— *48-person firm in the South, mixed specialization*
- Commercial requests have had a huge jump, with the leveling off of interest rates and new programs for LEED tax credits.
— *17-person firm in the Midwest, commercial/industrial specialization.*