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2007 Projected as Another Strong Year for Nonresidential Projects

AIA Consensus Forecast Panel sees continued economic expansion with balanced growth across commercial/industrial, institutional sectors

	Consensus		McGraw-Hill Construction Bob Murray 781-860-8623 Contract Awards (billions of 2000\$)		Global Insight Patrick Newport 781-301-9125 National Income and Product Accounts (billions of chained 2000\$ private structures only)		Portland Cement Association Edward Sullivan 847-972-9006 Spending Put-in-Place (billions of 1996\$ private structures only)		Economy.com Mark Zandi 610-235-5151 Spending Put-in-Place (billions of 2000\$)		FMI Heather Jones 919-785-9335 Spending Put-in-Place (billions of 2000\$)		Reed Business Information Jim Haughey 817-556-4257 Spending Put-in-Place (billions of 2000\$)	
*2006 are estimated figures	ACTUAL	FORECAST	ACTUAL	FORECAST	ACTUAL	FORECAST	ACTUAL	FORECAST	ACTUAL	FORECAST	ACTUAL	FORECAST	ACTUAL	FORECAST
	2005	*2006 2007	2005	*2006 2007	2005	*2006 2007	2005	*2006 2007	2005	*2006 2007	2005	*2006 2007	2005	*2006 2007
	\$	% change	\$	% change	\$	% change	\$	% change	\$	% change	\$	% change	\$	% change
Nonresidential Total		5.9 6.8	141.1	4.0 1.0	251.5	8.9 8.1	130.9	12.1 7.8	202.0	6.7 7.3	243.6	0.2 6.7	250.1	3.7 9.3
Commercial Total		4.8 6.5	59.8	7.0 -2.0	86.2	4.7 5.3	98.9	12.3 8.7	98.5	4.9 10.3	108.1	-2.8 6.4	111.9	2.7 10.2
Office		2.8 9.0	18.4	13.0 4.0	33.2	9.7 12.5	29.3	6.5 8.7	32.9	0.3 11.6	41.5	-0.2 4.9	42.9	-3.6 12.3
Retail/Other Comm.		3.6 3.5	35.9	-2.0 -3.0	52.9	1.6 0.5	40.8	7.8 6.4	99.8	5.8 6.5	62.1	4.4 5.5	63.8	4.6 5.0
Hotel		23.8 13.1	5.6	49.0 -12.0	12.7	41.8 6.0	8.5	37.6 10.3	9.8	13.7 26.1	9.2	-13.9 17.3	10.0	14.3 28.5
Industrial Total		9.7 5.4	8.9	4.0 -1.0	19.8	12.2 4.7	20.3	19.2 12.4	22.1	9.4 2.0	20.7	4.5 10.4	22.3	8.5 4.4
Institutional Total		2.8 5.3	74.5	2.0 4.0	N/A	N/A N/A	N/A	N/A N/A	174.0	2.8 1.8	113.1	1.4 6.1	137.6	4.8 8.7
Health		8.0 6.8	14.7	-1.0 -2.0	18.1	17.8 10.1	13.3	22.6 5.5	5.9	-1.1 4.3	24.7	3.7 8.8	24.7	6.0 14.5
Education		0.4 4.2	32.3	4.0 6.0	11.4	-3.9 4.8	8.4	1.2 2.4	47.8	0.3 0.6	56.0	0.3 4.8	57.3	0.5 6.6
Religious		-2.7 2.6	3.5	-8.0 3.0	6.0	-2.6 1.6	5.1	2.0 3.8	N/A	N/A N/A	6.4	-2.9 0.0	6.6	-1.8 4.3
Public Safety		2.7 4.5	6.2	-2.0 5.0	N/A	N/A N/A	6.6	6.1 2.9	7.8	1.4 -1.3	7.8	3.9 6.5	7.9	3.8 9.6
Amusement/ Recreation		5.3 9.9	4.9	4.8 9.5	7.4	17.3 21.1	18.4	-1.1 1.8	N/A	N/A N/A	16.2	-0.5 6.3	15.8	6.0 11.0

by Kermit Baker, PhD, Hon. AIA Chief Economist

Summary: If you liked the nonresidential construction market last year, you'll probably love it this year. Building increased almost 6 percent in 2006 even after adjusting for inflation, and the pace of growth is expected to pick up a bit more this year, increasing by almost 7 percent across the nonresidential building category. Pacing the upturn is projected strong construction activity in office buildings (+9 percent), hotels (+13 percent), and hospitals and health care (+7 percent). These are some of the principal conclusions from the most recent AIA Consensus Construction Forecast, a semi-annual survey of the nation's leading construction forecasters. In

the mid-year update published last June, this panel expected nonresidential activity to increase 6.3 percent in 2006 and 6.2 percent in 2007. Current estimates are that 2006 will come in just a little weaker than was expected last summer, and that this year will be a little stronger. If these forecasts prove to be accurate, 2006-2007 would be the best two-year period for the industry since the late 1990s.

For architecture firms, another banner year for nonresidential activity means more projects to choose from, growing workloads, tighter deadlines, additional staffing concerns, and increased problems of finding available contractors. However, because design activity generally leads construction activity

by 9-12 months, much of the anticipated new work may be well through the design process. If so, the second half of the year could be slower than the first half, so market conditions should be more closely monitored as the year progresses.

Broader economy slowing
The prospects for nonresidential construction activity growing at the pace predicted by the AIA panel depend largely on the national economy avoiding a significant slowdown. There are a few vulnerabilities developing in the economic outlook, as our gross domestic product grew more slowly in the second half of 2006 than it did in the first.

At the top of the list of weaknesses is

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the homebuilding market. New housing starts declined 13 percent in 2006, and are expected to drop as much again this year. A weaker housing market not only directly cuts into our economic output, but indirectly affects consumer spending activity. Rising house prices increased the level of equity homeowners' held in their homes, and many owners tapped into this equity to support other household spending activity, such as home improvements, college tuition payments for their children, automobile purchases, and so forth. As house price gains continue to moderate—and even fall in some markets—owners will have less equity to withdraw and will be more hesitant to extract what they have built up over the years.

Other sources of concern with the economic outlook include a weakening U.S. dollar, continuing high oil prices, and emerging weakness in the manufacturing sector. The dollar has fallen relative to the currencies of our major trading partners for the past two years, and this weakness is expected to accelerate this year. While a falling dollar may help boost U.S. exports, it also increases the prices of imports, which means higher inflation for foreign products. Oil prices have stabilized and even eased off a bit, but they remain well above levels we saw earlier this decade, and are unlikely to fall back to these levels anytime soon. The manufacturing sector of our economy, which traditionally has supported higher wages than for comparable service-sector jobs, has recently shown signs of weakness. The Institute of Supply Management Manufacturing Survey, which surveys purchasing managers at major manufacturing companies, has been reporting much slower growth for the past two quarters. A downturn in manufacturing would severely weaken overall economic growth.

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Despite these vulnerabilities in the economic outlook, the consensus is that our economy will grow in the 2.0 percent to 2.5 percent range in 2007. Although below the pace of growth of the past few years, that level indicates a reasonably healthy economy that can support a vibrant nonresidential construction market. Trends that point to continued growth in the economy include strong profits encouraging growing levels of business investment, stable levels of inflation—particularly in construction materials—that allow interest rates to remain stable, and improvement in consumer confidence levels.

Rising stock market prices over the past year indicate that U.S. businesses are basically healthy. This in turn has encouraged increased levels of investment in their operations. Business investment increased 7.5 percent last year on top of 6.8 percent in 2005, and most projections are for another 5 percent or so increase this year, producing a healthy climate for nonresidential construction.

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As the economy has begun to slow in recent quarters, inflation has begun to ease. Oil prices have been mod-

erating, and construction materials used in nonresidential buildings have increased only 4.1 percent over the past year, according to U.S. Department of Labor figures, even declining 0.6 percent during the fourth quarter of 2006. Prices for some materials remain much higher than a year ago (e.g., asphalt, copper, steel, aluminum, and cement) but even these materials have seen a significant moderation in prices over the past quarter. If inflation in the broader economy remains under control, and the economy stays in a slow-growth mode, there is room for the Federal Reserve Board to cut short-term interest rates.

A final positive for the economic outlook is improving consumer confidence. Both the University of Michigan and Conference Board measures of consumer confidence have improved recently and are above the average for 2006 as a whole. Rising consumer confidence scores generally indicate that consumers are willing to make consumption and investment actions necessary to keep the economy growing.

Healthy construction outlook

Commercial and industrial facilities—offices, retail space, hotels/motels, and manufacturing and distribution space—tend to be the strongest nonresidential sectors when the economy is expanding, and 2007 looks to be no exception. Our AIA Forecast Panel expects commercial construction to increase 6.5 percent this year, including 9.0 percent for office space and 13.1 percent for hotel facilities. National office vacancy rates continue to show improvement, declining from 13.9 percent in the fourth quarter of 2005 to 12.6 percent in the fourth quarter of 2006, according to the CB Richard Ellis National Office Vacancy Index. Only 13 of the 51 metro markets tracked

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in their surveys failed to see a decline in office vacancy rates over the past year, and many saw significant declines. While vacancy rates below 12 percent generally can support new speculative construction activity, 11 markets currently have rates below 10 percent, topped by Manhattan (5.7 percent), Orlando (7.0 percent), and Ft. Lauderdale (7.2 percent).

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The health-care market looks to be the strongest institutional category in 2007, with gains of 6.8 percent projected on top of 8.0 percent in 2006. Education construction, the other big institutional category, is expected to increase a solid 4.2 percent after inflation adjustments. Together, health care and education account for about 60 percent of institutional construction activity. The upturn in health-care construction is resulting from increased profitability, in part due to consolidation, which has allowed greater efficiency of operations and often less competition. Additionally, Medicare reform has improved the financial position of many hospitals. And, given the aging of our population, with the record wealth of today's retiring population, health care looks to be a growth market for years to come.

PODCAST!

Listen to AIA Chief Economist Kermit Baker, PhD, Hon. AIA, discuss the latest AIA Consensus Forecast with Robert P. McCarthy, vice president and research analyst in the Equity

Research Department at Banc of America Securities LLC; and Patrick Newport, PhD, economist for Global Insight's Macroeconomic Service; and AIA moderator Scott Frank.
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