

The construction market in 2016 and beyond.

economics

HOW LONG WILL THE GOOD TIMES LAST?

BY JOHN CROSS, P.E.

GOOD TIMES FOR CONSTRUCTION? That may be a bit of an overstatement.

For the nonresidential building construction market, the impacts of the Great Recession of 2008 through 2010 are still being felt. Nonresidential construction has not returned to prerecession levels; in fact, nonresidential construction levels have only grown by 250 million sq. ft from the dark days of 2010 and are still 737 million sq. ft below the peak level of 2007. The fact is that we have only regained 25% of the nonresidential market that was lost in the recession.

The recovery that has occurred in the building construction market has been in the residential sector and unlike prior recoveries, this recovery has been centered in multifamily buildings, not single-family homes. Single-family residential starts dipped from a high of 1.6 million units in 2005 to a low of 413,000 units in 2010. The market has recovered to 750,000 units in 2015. Similar to nonresidential construction, single-family home construction has only recovered 28% of the lost volume. But the same is not true of the apartment and condominium market, where 72% of the market lost during the recession has been recovered. This is particularly the case in multistory apartment and condominium projects greater than four stories in height, where activity has surpassed prerecession levels by 9%. This demographic shift is the result of a variety of factors including a generational desire to live in an urban environment, a reticence to invest in single-family homes, high college debt levels resulting in a lack of funds for down payments and a preference for rapid relocation.

So what does all of this mean for construction activity in 2016? The answer to that question is a balancing act between a series of competing influences that can best be addressed as a series of questions...

If nonresidential construction has not yet bounced back from the recession, does that mean that we are poised for a major increase in construction activity in 2016?

No, nothing in the data suggests robust growth in 2016. The AISC Business Barometer indicates a modest level of pessimism among structural steel fabricators, the AIA Architect's Billing Index is vacillating around neutral growth and the Dodge Momentum Index is taking one step back for every two steps forward.

Is there pent-up demand for nonresidential construction?

No, during previous construction cycles, growth in single-family housing generated demand for new schools, strip malls, office buildings and hospitals. This cycle is characterized by multifamily apartments and condos primarily being constructed in urban centers where nonresidential infrastructure already exists. While this activity may spur renovation of existing nonresidential buildings, it is not the same driver for new construction as greenfield single-family residential construction. In addition, many of these multistory residential projects are actually limited mixed use projects that include some retail and office space.

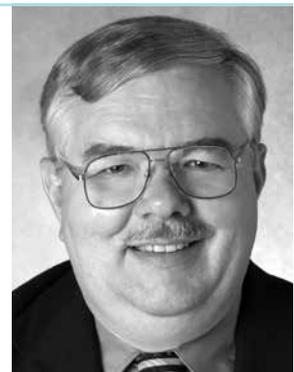
Is the current trend away from suburban single-family homes to urban apartments and condos a short-term phenomenon or a long-term reality?

It is unclear what the housing market will look like in ten years, but for this construction cycle the demand will continue to be for urban living rather than suburban single-family homes.

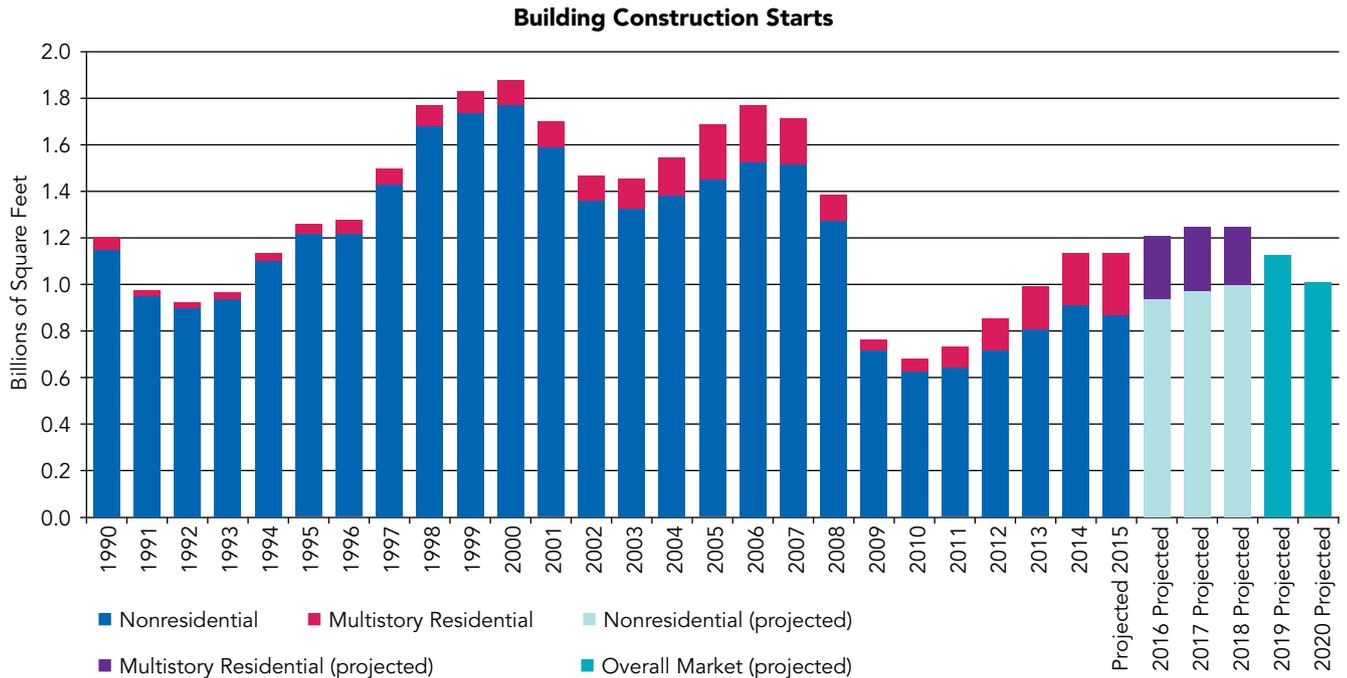
Is the overall economy pointing to a decrease or increase in construction activity?

The signals are mixed. Third quarter GDP growth was originally reported to be just 1.5%, which sent chills up and down the spine of every economist. Subsequently, the Bureau of Economic Analysis revised the third quarter GDP estimate to a much more comfortable value of 2.1%. At the same time, predictions for 2016 indicate GDP growth of 3.1%, a level that would support robust construction growth. At the same time, the government is reporting a 5% unemployment rate, which should indicate a growing workforce driving economic

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and construction growth. However, the optimism of a low unemployment rate is offset by a decreasing labor utilization rate, indicating that a smaller percentage of eligible workers is employed or actively seeking employment. In addition, a low unemployment rate is typically accompanied by a spike in average earnings, which has not occurred in this cycle.

Is new construction economically viable?

Yes, prices for existing homes and commercial properties in central business districts are continuing to rebound from recessionary lows and are approaching parity with new construction.

Is financing available to support expanded construction activity?

Yes, there has been a gradual loosening of lending standards over the past two years, and interest rates are at a historic low. While some hesitation exists in financial markets regarding the impact of the Fed raising interest rates, it is doubtful that rate will rise by more than 1% over the next year, still leaving rates significantly below the traditional long-term level.

Are businesses poised to invest in capital expenditures such as buildings?

No, even though consumer spending is rising, capital expenditures by companies have declined by nearly 4% during the first 10 months of 2015. While some of the pullback in capital expenditures is the direct result of low oil prices impacting the energy industry and a strong dollar limiting exports, the trend is evident across the broader economy.

Is the construction sector poised for a cyclical downturn?

Historically, five to six years of growth follows the bottom of a construction cycle. The current construction cycle started in 2010, indicating that a peak should be experienced in 2015 or 2016, followed by a cyclical downturn. But this cycle has not been typical in that it began from a lower bottom and it has not experienced any periods of rapid growth. This would seem to indicate that the current cycle will be more extended than prior cycles.

So what are construction levels expected to be in 2016 and beyond?

It is anticipated that nonresidential building construction activity will grow by 6% to 8% in 2016. During this same period, multistory residential activity will grow by an additional 5% to 6%, resulting in an overall growth in the nonresidential plus multistory residential sector of 6% to 7%. While the mix between nonresidential and multistory residential construction will change in 2017, the overall level of growth will be similar, with construction activity reaching 1.2 billion sq. ft. The peak reached in 2017 will be maintained in 2018, followed by a gradual reduction in construction volume over the next two to three years. This compares to 1.7 billion sq. ft at the last peak in 2007 and 680 million sq. ft at the bottom of the recession in 2010.

Where will this growth be most apparent?

From a project type perspective, growth will occur in office market (+17%, mostly in central business districts), arena and stadiums (+15%), warehouses (+9%) and schools (+9%). It should be noted that the growth in office construction, while at 17%, is still significantly below pre-recession levels. Geographically, the greatest regions for growth continue to be in the southern states. ■