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Building Construction

2007 construction outlook strong in some areas, but housing is weak

U.S. construction spending is expected to decline slightly in 2007, resulting largely from a decline in single-family housing activity.

At the same time, other construction sectors are expected to show increases, including institutional and manufacturing buildings as well as public works, especially highways, bridges and environmental projects.

Despite the soft housing market, material costs will continue to rise in the coming year, resulting from sizable demand from other industrial sectors as well as global demand for some materials, including metals.

Hospital, lodging and energy-related construction remain the best bets.

What to expect

In its 2007 construction outlook, McGraw-Hill Construction, a unit of The McGraw-Hill Companies, projected a 1 percent U.S. construction market decline in 2007. It further projected the second consecutive weak year in the housing market, which boomed from 2000-2005, but declined at a faster rate than expected in 2006.

"The construction industry no longer has single-family housing to bolster total construction," said Robert Murray, vice president and chief economist at McGraw-Hill Construction.

Despite the weak outlook for single-family housing, Kenneth Simonson, chief economist for the Associated General Contractors in Arlington, Va., the largest U.S. construction trade association, says that multi-unit construction "looks robust, thanks to a spurt in rental construction."

Nonresidential construction to the rescue

The 2007 outlook for nonresidential construction is substantially better.

McGraw-Hill projected significant growth in institutional construction (e.g., hospitals, schools) of 7 percent in dollar volume and 4 percent in square footage; 14 percent growth in manufacturing facility construction from a weak 2006 performance; and a 10 percent gain in public works construction.

Orders for construction materials and supplies were up by 6 percent for the year-to-date through October.

"Contractors have been optimistic for most of the year about the long-term outlook for construction," Simonson said.

There has been no letup in the torrid pace of private nonresidential spending growth, Simonson said in early January, after November construction spending data were released. He noted that hotel and resort construction in November was up 71 percent from a year earlier and that electric power construction was 18 percent higher.

Nonresidential construction increased across the board from November 2005: manufacturing, 11 percent; healthcare 20 percent; and commercial construction, 11 percent.

In public sector construction, highway and street construction in November was up 14 percent from a year earlier, and education spending was nearly 7 percent higher.

Material costs continue to outpace other prices

Construction material costs took a breather in November, declining 0.5 percent, Simonson said. But construction costs were up 5 percent in the past 12 months, versus only 2 percent for the Consumer Price Index and just 0.9 percent for the finished-goods Producer Price Index.

“Two factors make construction materials costs susceptible to steeper increases than the overall rate of inflation,” Simonson said. “First, construction requires generally fixed quantities of materials, unlike industries that can substitute cheaper materials or can design products to be smaller or lighter than their predecessors.”

He also noted that many construction materials are in demand from other sectors – not just in the United States but in rapidly growing economies such as China, India and elsewhere in Asia.

Second, Simonson said transportation costs for delivery of construction materials are high, and fuel price hikes add to both transport costs and direct costs of operating construction equipment.

Nonresidential will continue the momentum

“Nonresidential construction appears to be in good shape to build on the momentum of the last year. Hospital, lodging and energy-related construction remain the best bets. Expanding public works budgets, thanks to record volumes of bond approvals in November, also will help contractors,” Simonson said.

But noting the slowing economy, he predicts that even nonresidential construction will grow in the 8 to 10 percent range this year rather than the significantly greater rate through November 2006.

Multi-unit residential construction will benefit from growth in rental construction, which should approximately offset a drop in condo construction, Simonson said. But a 10 to 15 percent decline in single-family construction, and a small downturn in improvements, will keep total construction from showing growth.

Watch for growth opportunities

Homebuilding contractors will need to expand their marketing activities to seek a larger share of a smaller single-family market. Multi-family building and hotels represent an opportunity to tap into growing markets.

Those contractors operating in the nonresidential area should seek out opportunities in the expanding sectors such as the educational and hospital markets.

In addition, all contractors will need to monitor costs carefully to see where they can hold the line in the face of continuing rising labor and material costs.

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