North American Construction Outlook Moderate in 2004, but Assumption of Growth Expected in 2005

Despite all of the variables in the economy that can effect construction, optimism for a strong rebound in the new year remains for the North American construction industry. Industry analysts and economists gathered to present their outlooks for 2004 and beyond at Reed Construction Data’s North American Construction Forecast conference held at the National Press Club on Oct. 15, 2003.

According to Gene Sperling, former national economic advisor and director of the Economic Council, the forecasting community is very bullish about the U.S. economic recovery. Many predict 3.5 percent to 4 percent growth going into the first half of 2004 and others see things moderating. Sperling, who characterized himself as a blaséist, is a little more cautious. “I’m not in the pessimist camp, but I’m certainly not overly optimistic like so many others — just cautious,” said Sperling.

There was no question that the characterization has been a mild recession, but the
United States has had a very disappointingly mild recovery, according to Sperling. He said looking at the five quarters between the second quarter of 2002 and the first quarter of 2003, there were three quarters below 1.5 percent growth. As well, the economy continues to be in a period of job loss nearly 22 months after a recession. All of this signifies that there has been considerable uncertainty that has continued to plague the U.S. economy.

Edward Sullivan, chief economist of the Portland Cement Association, like many of the other more optimistic economists Sperling mentioned, sees the economy continuing to gain strength in 2004. Although, Sullivan said the construction market is going to be down this year by 1 percent to 1.5 percent and doesn’t expect much growth next year in terms of real construction. He suggests that the market will be flat in 2003 and 2004, but at a very high level. 2005 will bring the United States an assumption of growth in construction. Moving forward, as interest rates begin to rise, residential will no longer be the leader. Non-residential will become the leader.

In addition to Sperling and Sullivan’s forecasts, other construction industry analysts and economists presented forecasts on the individual sectors of the construction industry as well as the outlook for Canada and Mexico. What follows are excerpts; complete coverage can be found online at www.nacf.com.

**Predictions for Individual Sectors**

**Retail/Industrial/Office Outlook.** Glenn Mueller, managing director, Real Estate Investment Strategy, Legg Mason, Inc. and professor and investment strategist at Johns Hopkins University Real Estate Institute, suggests going forward, office demand is coming back. Currently, the projection is that by 2005 the United States should return to the long-term average of 2 percent growth and see some new demand coming along, while hotels remain depressed at a 35 percent vacancy rate. He also mentioned that retail continues to do well in most regional markets, and with continued urbanization, the United States could expect to see more neighborhood community centers in the near future.

**Federal Reserve Regional Outlook.** Ray Owens, vice president and senior economist for the Federal Reserve Bank, says signs of economic pickup combined with sharp curtailments of new construction have laid the foundation for more solid performance going forward, but risks remain. Much of the improvement in commercial real estate may be tied to improvement in the labor markets, and although there are some encouraging signs in the labor markets, continued sluggish growth could limit an eventual pickup in demand growth. He says the need for space may not be as rapid as what we saw after the last recession in the 1990s but nevertheless, the turnaround in net absorption is powerful evidence that the conditions are improving.

**Residential Outlook.** David Seiders, chief economist for the National Association of Home Builders, reported that housing has been a heroic performer throughout the entire recovery, and Seiders believes the United States can retain the levels of home sales and housing production that have been generated in recent times, which have been quite strong. However, he said he would be surprised if we could continue to post growth in these areas without getting reasonable job growth. He is looking for this part of the sector to fall into place very soon because the 30-year mortgage rate is now heading toward 6.75 percent, compared to historic lows of 5.2 percent in June. On other fronts, residential remodeling is performing very well, according to Seiders. He says this $180 billion market, as recorded in the first quarter of this year, is growing. He expects a 4 percent to 5 percent growth in this sector in 2003 and 2004. This pace will hold steady in 2005.

**Canadian Outlook.** Roger Grant, vice president of Reed Construction Data, said residential construction, like that of the United States, is very strong with more than 205,000 starts expected this year, spurred by low mortgage rates. Housing, similar to many of the construction markets in Canada, is fairly cyclical and appears to be near a peak. Some return is expected in the office building market in 2003 and out into 2004. And the one bright spot in commercial, as in the United States, is the retail market. Actual 2003 starts are expected to be near 16 million square feet, which is up significantly from last year’s forecast of just over 9 million square feet. This appears to be a very stable and strong market driven by consumer spending and the strong residential market. In total for industrial, commercial, engineering and institutional construction, strength is building...
in these sectors in the latter half of 2003, and it is expected that this trend will hold going into 2004. As a result, Canada will have stronger construction growth in 2004 and continue to lead the other North American countries in this regard.

**Mexican Outlook** The Mexican economy is expecting total growth in construction for 2004 to be in the 3.5 percent to 4.5 percent range. There is a strong demand for educational facilities, and the Fox administration has committed to redirect more funds to educational construction. Some growth is being seen, but modestly in 2004. Engineering construction is also projected to expand. There is quite a pent-up demand for infrastructure in Mexico. Currently, there are some reforms that are helping to secure some of the needed electrical generation and road construction. In 2004, there will be growth in the 3 percent to 4.5 percent range. Overall, 2003 construction growth should end up in the 1.5 percent to 2.5 percent range. Look to the infrastructure and nonresidential building sectors to be the strongest growth areas of the Mexican construction market in 2004.

**Major Projects and Trends: A Panel Discussion**

Gordon Mills, chairman, CEO, Durrant, sees much opportunity for growth in 2004, exceeding that of 2003. Criminal justice, community colleges and healthcare are a few of the strongest market sectors expected for 2004. Business area transformations that are being seen include integration of design and delivery, where there is close collaboration of everyone involved in the process to aid in the transfer of knowledge.

Charles Rodenfels, senior vice president, URS, noted that government buildings, such as the Herbert Hoover building and the Pentagon, are receiving a great deal of attention in terms of renovations and improvement of infrastructure. This appears to be a growing trend going forward, and federal funding is becoming available to support these renovations.

Gary Haney, design partner, Skidmore Owings & Merrill, said they have focused on diversity and pursuing projects that would allow them to exhibit their strength in design and technical excellence. Last year, 27 percent of their volume was financial, corporate mixed-use projects. Airport and transportation accounted for 24 percent; government projects 24 percent; health and science was 13 percent; education is now 7 percent, and he expects this to double next year. He reported that tall buildings continue to be in demand. Currently there are developments in process to make these buildings safer including structural improvements to resist progressive collapse, responsive building skins, wider stairs, concrete cores and improved fireproofing.

Richard Tomasetti, co-chairman and managing principal, Thornton - Tomasetti, reported that today they are seeing more consideration for making high-rise buildings in urban environments with mixed uses. These combined projects are offering new opportunities for material specialists because the industry is seeing
more use of mixing the appropriate amounts of concrete and steel in both residential and office buildings. Combining these elements in office buildings is motivated by security concerns.

Clark Davis, vice chairman and CEO of HOK, observed that in many cases, speed of design and delivery are now more important than cost in many of the projects they are undertaking. They have remained active in the hospitality business and also have had ongoing work in the retail and mixed-use commercial business. He reported that things continue to be slow for corporate offices and interiors. HOK’s backlog in the middle of the country has doubled since the beginning of this year. Regionally, Southern California is strong, but the East Coast and the bay area are a little slower to recover.

Michael Schneider, executive vice president of Parsons Brinckerhoff, said the three Cs they are facing as trends are commoditization, consolidation and commercialization of the practices in the design, engineering and architecture industry. The position of the design and construction industry is becoming stronger, and clients are not only looking for one-stop shops but also for ease of shifting risk or shifting responsibility — not only in the design and construction stage but also in the operations and maintenance stages.

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