The 1987 Dodge/Sweet’s Construction Outlook

McGraw-Hill Economist Predicts a 2% Drop This Year

After a longer than average period of expansion, the construction market is showing signs of weakness that will become more evident in 1987, industry leaders were told today by one of the nation’s foremost economic analysts.

George A. Christie, vice president and chief economist for McGraw-Hill Information Systems Company, pointed out that “in the absence of a credit crunch, the cyclical decline of the construction sector that is just beginning will be long and gradual rather than quick and severe. The initial step down in 1987 is likely to be a small one.” He forecasts a 2 percent drop in construction contracting to $235.1 billion.

The setback in construction spending will be concentrated in the non-residential market, with office building hardest hit. “The onset of tax reform means getting back to basics,” Christie noted. “That means building offices intended to shelter workers, not income.”

The McGraw-Hill economist presented the assessment this afternoon at the Building Products Executives Conference, a major forum for business leaders held annually by McGraw-Hill Information Systems Company. The firm, a leading authority on the construction market, is widely known for its Dodge Reports on construction activity, Sweet’s Catalog Files of construction product information, building cost estimating systems and construction industry magazines.

In presenting his annual forecast, the 1987 Dodge/Sweet’s Construction Outlook, to 600 industry leaders attending the Conference at the Capital Hilton Hotel, Christie indicated that “the need to absorb upwards of 200 million square feet of surplus office space will severely depress new construction for several years. The adjustment is already in progress, but it still has a long way to go,” according to Christie.

Nor will nonresidential construction be getting any help from the industrial sector next year, Christie told his audience. “The persistence of the U.S. balance of trade gap will continue to depress industrial construction for the next two years at least. Contracting for new manufacturing facilities isn’t likely to break out of the 140-to-150-million-square-foot range until industrial capacity utilization crosses the 80 percent threshold.

“The bright spot in nonresidential building is retail construction, expected to total 535 million square feet next year,” the economist continued. “Even though this represents a small decline, anything over 500 million square feet must be considered a good volume. When it happens three years in a row, it’s very good.” Nonresidential construction overall is now forecast at 1.2 billion square feet in 1987, down 7 percent from this year’s anticipated volume. In contracting value, nonresidential construction will total $74.9 billion, down 4 percent.

Fewer housing units will be built in 1987 too. “Because rental housing has been overdeveloped in recent years by the lure of tax shelters, this part of the market is due for correction as tax reform is brought to bear,” Christie said. “This puts the burden of sustaining the momentum of the critical residential sector squarely on single family building. The problem? Single family building is already so good there’s little room for improvement.”

With the continued support of favorable mortgage conditions, single family homebuilding is capable of a small increase in 1987, but with multifamily building falling sharply, total housing starts will shrink to 1,750,000 units next year, a decline of 5 percent. Residential contract value will remain steady at $120.3 billion.

Nonbuilding construction (public works and utilities) is expected to ease 3 percent next year to just over $40 billion. “The five-year recovery of

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Public works construction is now flattening out, but no serious setbacks lie ahead,” Christie pointed out. “Following the surge of transportation-related projects, which carried total public works construction from $25 billion in 1981 to almost $40 billion in 1986, contracting is now settling into a $38-to-$40 billion a year groove. It will stay there as long as Federal funding is restrained.”

Regionally, the North Central States will post the strongest gain in construction contract value, rising 2 percent next year. Construction will be up one percent in the Northeast, but down 5 percent in the South and 2 percent in the West.

### Commercial Building More Selective In 1987

New commercial building faces a generally good outlook for 1987. Overall activity may be down 6% to 8% because the office building market will still be adjusting to very high vacancy rates in some parts of the country. On the other hand, commercial repair and remodeling is expected to have another strong year.

Gypsum manufacturers view the new commercial building market as second only to new home building, with respect to size. About 3.5 billion feet of gypsum wallboard will be used for new commercial building next year. Another 2.5 billion feet will be needed for repairing and remodeling existing commercial buildings. Close to one third of all the gypsum sold goes to these two non-residential markets.

Awards for new office buildings are down 20% this year and expected to continue to decline through most of 1987. High vacancy rates, particularly in the South, have placed a damper on starting new projects. The energy states—Texas, Oklahoma, Louisiana, and Colorado—have been particularly hard hit. Curiously, other regions, especially the Northeast, can expect office construction to have another good year in 1987, because demand continues strong and vacancies are moderate to low in these areas.

As a partial offset to a weak office market, store, school and hospital construction is performing well this year and will continue strong in 1987. It is characteristic of this type of building to experience a solid uptrend follow-
ing good years for new home building. The lag is normally one to two years. Home building has been brisk since 1983, and new commercial construction related to that market should stay at high levels for the next two years.

In 1987, commercial repair and remodeling activity will score modest improvements of 3% to 5%. High office vacancy rates cause owners to step up remodeling and renovation programs. This is preferred to cutting rent in order to keep their buildings filled and to discourage tenants from moving.

During the late 1960s and for most of the 1970s, the nation experienced very high levels of new commercial building activity. Many of these structures are now 10 to 20 years old and in need of modernization, renovation or major repairs. This should provide a solid base for continuing year-to-year increases in commercial R&R expenditures for the balance of the 1980s.