A View From the Trough
An Outlook on the Building Materials Marketplace in the 90s

By P. Jack O'Bryan, CEO
United States Gypsum Company

Editor's note: Following is an edited version of an address delivered by Mr. O'Bryan at the AWCI Award& Luncheon during the 75th Convention.

I decided to entitle my speech “A View From the Trough” rather than the original--A View From the Top, considering we’re coming out of the bottom of a building cycle.

And what is the view from the trough? Many of my trough mates think the worst of the current building bust is over and that we’re on the way back up. On the surface, the first couple months of the year would seem to indicate that was true. There are, as we said, recent encouraging signs. But that still doesn’t mean we know which way is up. In other words, nobody knows for sure what the future holds, but if we take a lesson from the past, we can see that we’ve made it through tough times before. And, while each recession is unique, thankfully, they all have one thing in common--a recovery.

That much is clear if you look at housing start cycles for the past 25 years (see Fig. 1). We had recessions beginning in 1964, 1973, 1979 and 1987. Each of these lasted an average of four years and showed housing start declines of 30% to 40%.

But each recession eventually ended in a recovery. The recoveries we saw in 1967, 1971, 1976 and 1983. I believe we will also see a recovery in 1992, but it will be significantly more modest than those of previous years.

Now what about nonresidential construction where similar cycles have taken place (see Fig. 2)? From 1969 to 1991 there were three separate recessions and recoveries in this area. And that cycle has repeated itself in spite of the variety of end uses in this category including office, manufacturing, education, health care and public building construction.

But unlike non-residential and housing, one segment of the construction industry has not been cyclical and has in part escaped the ravages of recession. That is repair and remodeling. Over the last 10 years, the average annual growth rate for residential remodeling alone has been 13%, which makes it the fastest growing segment of the total U.S. construction market (see Fig. 3). Even more significant, repair and remodeling has grown to represent 40% of total U.S. construction spending. But impressive as these numbers are, not even this growth category is immune to the current economic downturn, and slight declines are expected in the soon-to-be-reported repair/remodel expenditures for 1991.

Clearly, times are tough. While many of us believe a building industry recovery is just around the comer--and we’re beginning to see some signs that this is true--we’ve got to remember that our beliefs are always being tested. Just like they were in 1975, in 1982, and like they probably will be again in the future. But anyone who is farsighted enough to believe in our business will reap the benefits of their optimism--hopefully, soon.
So how soon is soon? What are we looking at for the rest of the 1990s? For starters, the entire demographic profile of the country will change, and for those of us in the building industry, it’s a mixed bag.

On the positive side, the largest population in American history will be reaching the 35 to 54 year old age bracket, the bracket with the highest level of household spending including the purchasing of homes. Traditionally, this group includes two types of home buyers—the younger or move-up segment which we expect to account for about 65% of the new home market in the 10 years between 1990 and 2000, and the older members of the group who are buying second homes such as retirement or vacation residences.

We’ll also see above average growth in the 0 to 14 year old age bracket and in the 65 and older group. The impact of these numbers will primarily be felt in institutional building. For instance, since 1981, the square footage of educational building has increased every year. In fact, by 1990, high school construction doubled while primary school construction tripled. We’ve seen similar growth in the construction of health care facilities over the past decade and, with the anticipated growth of the 65 plus age group, we expect this trend to continue.

These are the favorable demographic factors. They’ll produce a strong demand for single family housing and institutional building well into the next ten years.

But there are some negatives in the picture, too. The baby bust generation, which is 25 to 34 years old, is not beginning to enter the housing market. Compared to their predecessors, the baby boomers, this is a much smaller group of first time home buyers. In addition, this group is staying at home longer or returning home, in some cases as single parents. It’s a factor many of us can relate to and a definite negative for new
The baby bust generation is a problem in another way, too. As this small group now enters the work force, it’s slowing the demand for growth in commercial office space because it’s taking longer to absorb current vacancies, a negative for new non-residential construction no matter how you view it.

So what does it all mean for new housing? In the 1970s and ’80s, housing starts averaged 1.8 million and 1.5 million respectively (see Fig. 3). In 1990, that number dropped to 1.2 million, and 1991 finished at just barely over one million units. However, over the next nine years we believe that figure will improve to annual average rates of 1.3 million (see Fig. 4). Now how does that 1.3 million annual average play out over the decade?

Housing starts hit bottom in January, 1991, at an 847,000 unit rate. Even though that number climbed to 1,167,000 in January of 1992 and 1,304,000 in February, it’s obvious that the recovery has been slow (see Fig. 5).

In fact, we believe, the February preliminaries notwithstanding, the figures won’t begin to improve consistently until the second half of this year. At that point they will total out between 1.1 and 1.2 million units. This trend will accelerate over the next few years and the cycle will peak around 1994 or ‘95 with starts of 1.5 to 1.6 million.
The recovery will come primarily from the single family sector. This is significant for us in the building materials industry since single family homes typically contain twice the square footage of multi-family units. In fact, the single family sector will probably comprise 75% to 80% of total housing starts for the next 10 years, particularly since scarce funding and high vacancies will keep multi-family units at historic low levels for most of the 1990s.

While I hope I’ve convinced you that things will get better, we could use some help from President Bush and Congress. After all, it couldn’t hurt, could it? In regard to the proposed economic recovery plan, I don’t want to get into the debate over the long term plan consequences, its possible effects on inflation and budget deficits. I will, however, share our near term perspective. Clearly, we think the plan will be a boost for us, especially in housing. But we’re uncertain about the degree and timing of the benefits. Consumer confidence and unemployment figures continue heading in the wrong direction. Financing for developers and contractors remains troublesome, and mortgage rates are inching back up. All of these factors represent significant hurdles which must be overcome if the plan being discussed is to have any real impact.

Now what about nonresidential construction? We believe that this market, in decline since 1987, will finally bottom out over the next few years, but this will set the stage for a gradual, modest nationwide recovery in the mid and late 1990s (see Fig 6).

Until that recovery begins, however, there will be less office and retail construction near term. Why? Fewer new offices will be built because of the slow
growth in white collar employment and because of continuing high vacancy rates. I can speak about this from personal experience since 100,000 square feet of the United States Gypsum building in Chicago is currently vacant and we’re simply not adding new employees. In terms of retail, new construction will be slow because there are already too many stores for the current, weak economic climate.

Ironically enough, when the recovery does come, it will be led by retail and institutional building—institutional in the form of schools and hospitals which will be benefiting from favorable demographics and retail because improvements in retail construction will most likely follow recoveries in housing and in the economy.

Another area where we forecast growth is in the residential repair and remodel segment. This is largely due to the growth we expect to see in the size and average age of the housing stock and because homeowners will find it more desirable to add onto or remodel their existing homes rather than to buy new.

Now I mentioned that during the 1990s, we see new housing starts averaging about 1.3 million units annually. This means after netting out removals, the U.S. housing stock will increase by one million units annually or a total of ten million units for the decade (see Fig. 7). That’s on top of the existing stock of 100 million units.

And those 100 million homes are growing older and lagging further behind today’s expectations for housing. Nationally, the median age of a home is 26 years, which means it was built in 1965. The typical home built that year was barely 1,500 square feet in size, compared to over 2,000 square feet for the average new home today. In addition, these older homes lack many of the amenities today’s homeowners expect. When you put all these factors together, they point to a favorable outlook for residential remodeling.

Factors point to a favorable outlook for residential repair and remodeling.

As the market begins to grow again, I believe you can expect a growing share of it. Today’s homeowner already prefers to have a professional do the work rather than doing it himself or herself. Over 80% of consumer expenditures are going to contractors. In the future, demographics point to an older population that is even less likely to do the work themselves. The results will be

Factors point to a favorable outlook for residential repair and remodeling.

As the market begins to grow again, I believe you can expect a growing share of it. Today’s homeowner already prefers to have a professional do the work rather than doing it himself or herself. Over 80% of consumer expenditures are going to contractors. In the future, demographics point to an older population that is even less likely to do the work themselves. The results will be
more work for you.

For some of the same reasons, you’ll also find more work in nonresidential repair and remodeling. Nonresidential building stock is aging. High vacancy rates in the office and retail segments are generating remodeling work as space turns over or is renovated to compete with new space coming onto the market. In other segments, including education and health care, many structures must be expanded to accommodate growth, or in some cases to accommodate technology, such as with the installation of computers in schools.

In terms of age, the national average age of nonresidential stock looks like this. Eleven percent was built before 1920, 36% built between 1921 and 1969, while 50% is over 30 years old. It all translates into opportunity.

Opportunity we at United States Gypsum plan to take advantage of by applying the traditions of the past and the lessons of the present--both of which will allow us to thrive in the future.

But as we work toward that future, we all know how challenging these present day lessons are. Industry-wide, we’re facing declining demand, extremely low wallboard prices, a highly leveraged financial base and economic distress that has led United States Gypsum to be described as a good company with a bad balance sheet.

In fact, that description probably applies to many of us here today. But that’s not all bad because we are, in fact, good organizations, organizations that have weathered the current storm. And we’ll emerge stronger, more committed to our industry, to our products, services, and ultimately to our customers. These are the values that will bring us a future of recovery, that will allow us to survive and thrive into the 1990s and beyond. It’s today’s view from the trough that will help us more clearly and profitably see the view from the top, tomorrow.

About the Author:
P. Jack O’Bryan is President and Chief Executive Officer, United States Gypsum Company. He received a Bachelor of Science degree from Missouri University, Columbia, Missouri. He joined United States Gypsum Company in 1958 as a Board Plant Production Assistant at Sweetwater, Texas and progressed through a variety of management assignments. In June of 1983, he was appointed General Manager, Southern Construction Products Division, and in 1984 was named Vice President of that division. He was appointed President and Chief Operating Officer of A.P. Green Refractories Company in April 1985, and President and Chief Executive Officer in August 1986. In April 1988, he became Senior Vice President-General Manager, Central Construction Products Region. He assumed his present position in February 1989.