Several defining factors will set the pace for continued economic prosperity for the nation and the construction industry in 1995. The first factor is the financial strength of the country. After two years of expansion, corporate profits are high, industries are nearing capacity and creating new jobs, savings institutions are healthy and the deficit is decreasing. The financial strength of the country will fuel construction next year.

The second factor is export opportunities. France, Germany, Italy, Spain and Japan all pulled out of recessions in 1993, and those economies are currently accelerating. Most of the developing countries will also grow at very brisk rates next year. U.S. corporations are better prepared to participate in the global economy, and our government is reinforcing that preparation with NAFTA and GATT.

Fiscal policy is another important factor in 1995’s construction scenario. With the Republicans in control of Congress, tax cuts are likely. Typically, tax cuts are an expansionary policy, though if combined with spending cuts, the policy can be neutral in its effect on

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the economy. The worst of the defense cuts and military downsizing is over, and the state economies of California, Connecticut and Maryland should finally begin to improve, though base closings will continue into 1995, dampening prospects in some communities.

The final factor affecting the construction industry is monetary policy. Throughout 1994, the Federal Reserve Bank moved to flatten the yield curve and increase interest rates. If inflation accelerates as expected next year, interest rates will continue to drift upward and housing will continue to drift downward.

Residential

Builders started more single-family houses in 1994 than any year since 1978. Sales of new single family homes rose 5 percent despite rising mortgage rates. Speculative building and the inventories of new homes for sale
increased throughout the year. New homes appreciated faster than inflation for the first year since 1989. With higher mortgage rates and home prices eroding housing affordability, larger inventories of new homes for sale, and builder expectations deteriorating, the prospects for single-family housing are diminishing. Multifamily construction improved substantially in 1994 with some 70,000 more starts in 1994 than in 1993. Declining vacancy rates, restoration of low-income-housing credits, new financing initiatives for multifamily projects by Fannie Mae and Freddie Mac, and the largest flow of immigrants since the 1930s have helped to shore up a very weak construction sector. As higher mortgage rates slow the move-up process from multifamily housing into single-family housing, expect multifamily construction to continue to improve.

Private Nonresidential

Private nonresidential construction is improving rapidly. The “overhang” of space that once plagued this sector has largely been absorbed after three years of economic growth.

Construction in the industrial, office and retail categories each experienced solid growth in 1994 and will show continued vitality in 1995.

As expected, construction of retail facilities jumped by about 10 percent in 1994, pushed by the remarkable activity in single-family housing in 1993 and early 1994. Retail building permits were up well
into double digits in 1994, fore-shadowing good growth in actual construction in 1995, and consumer confidence grew perceptibly in the closing months of 1994, indicating increasing profitability for retailers. Although the maturation of the housing cycle will in all probability be followed by reduced growth rates in the retail sector, substantial growth is expected in this sector next year.

Industrial construction bottomed in 1993 and registered its first growth year since 1990. Continued high levels of industrial capacity utilization, anticipated growth in exports, solid corporate profits and returning consumer confidence all point to another year of solid growth for the industrial segment in 1995.

Office construction revived slightly ahead of schedule, breaking a five-year string of declines in that sector. Although wide variations exist, not only from one city to another but between areas of the same city, desirable space is definitely short in many places. Nationally, vacancy rates have fallen to 16 percent, with almost 40 percent of the metropolitan areas surveyed by C. B. Commercial below the 14 percent structural vacancy rate. With office employment expected to continue growing into 1995, look for increased activity in the office sector.

Hotel construction declined in 1994 as a spate of resort/convention/casino projects came to an end. With the economy definitely on the upswing, a broader base for the hospitality industry is now in place. Building

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permit applications in this category were up well above the double-digit level in 1994. Even if not all the permit activity reaches the job site in 1995, substantial growth in hotel-motel construction activity is expected in 1995.

Institutional

Total institutional construction declined slightly in 1994, for the first time since 1977. Federal health care legislation and the new crime bill initiated a lull in institutional construction, while educational construction continued to improve. The pause should end in 1995 as demand for institutional services will require increased construction of facilities.

Construction in the educational sector grew modestly in 1994. The children of the Baby Boomers (the Baby Boomlet) are still adding to the enrollment of primary and secondary schools, and so is immigration. At the same time, enrollment in post-secondary facilities is benefiting from the realization that continuing education is a survival strategy demanded by the rapid pace of technological change, especially by the “electronic revolution.” The growing importance of education is evident through 10 years of increased spending for educational facilities, a trend that is likely to continue into next year.

Construction in the corrections and public safety sector declined slightly in 1994, though crime has been an important issue throughout the year. With the nation’s prison population growing at an average annual rate of 8.5 percent and the majority of state prisons operating over capacity, prison construction will continue to be in demand. The new crime bill, passed into federal law in 1994, will increase the amount of construction in this sector. The crime bill provides $7.9 billion for prisons (mostly for prison construction) between 1995 and 2000. The effect in 1995, however, will be small, with only $0.15 billion scheduled to be granted.

Healthcare construction declined moderately in 1994, as the industry waited to see what the new federal healthcare legislation would be. No legislation, however, was passed. All the demographic, social and economic reasons remain for adding to the stock of healthcare facilities, and for modifying the existing stock to make it more efficient. But at the same time, empty hospital beds are increasing as more procedures are being done on an outpatient basis and as the length of hospital stays decrease. Whether the administration and the newly Republican Congress can agree on a new law or not, there will be increasing pressure toward reducing this nation’s annual healthcare bill. Good news for the construction of reduced-care facilities or two- to four-bed wards. Bad news for the construction of full-blown multimillion dollar facilities. As a result, growth in healthcare construction will be modest in 1995.

Cooperation between Congress and the administration will be a key issue for future prison construction. With the Federal Reserve Bank intent on restraining the economy through higher interest rates, housing will begin its cyclical decline in 1995. However, the overall strength of the economy will boost total construction to new highs next year.

About the Authors

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