

CONSTRUCTION OUTLOOK

Housing Market Remains Bleak

by Tara Taffera

“I don’t think anyone is looking for housing to turn around in 2008,” said Robert Murray, vice president of economic affairs for McGraw-Hill Construction. This was the message he and other experts gave to those who attended the Construction Outlook 2008 Executive Conference held in October in Washington, D.C. Murray presented the 2008 outlook for U.S. construction activity.

The bleak forecast is due in part to tighter lending conditions and high inventories, according to Murray. Many speakers addressed the inventory problem, including Kermit Baker, chief economist for the American Institute of Architects (AIA), who presented an outlook for the housing and remodeling markets. He cited the statistic that inventories of vacant for sale homes ballooned—with an increase over 2005-2006 estimated at 750,000-800,000.

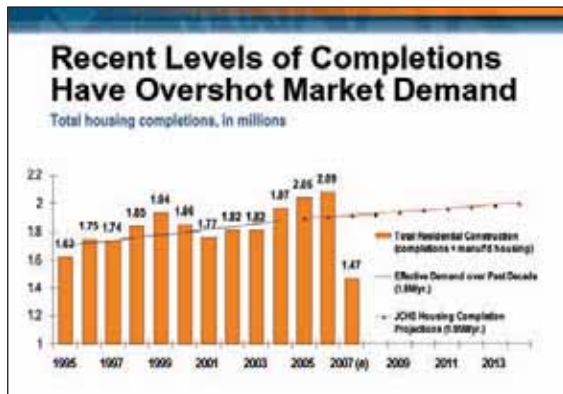
“This is the problem we have to work off until things get back to normal,” said Baker.

He said we *could* see a recovery in 2009 but was tentative with that prediction.

Though homebuilding is in the midst of a significant downturn, Baker said, “With every day this is becoming more significant than first expected.”

Though the next few years may look dismal, he did say that the long-term housing outlook is positive as there is strong household growth (which should be even greater in the coming decade than in the last), a vibrant second-home market and a more efficient industry as a whole. Negatives include affordability, land-use restrictions and high energy costs.

While new construction falters, Baker said remodeling does offer opportunities. He said positives for the long-term remodeling outlook are the aging housing stock, rising land prices/energy costs and high homeowner equity levels. “Often this translates into home improvement spending,” he said.

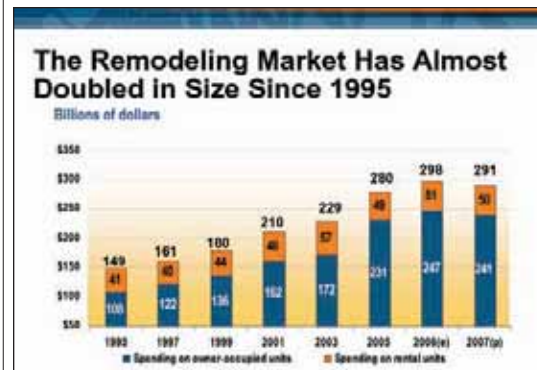


Source: U.S. Department of Commerce; Joint Center Projections

	History (1995-2004)	Forecast (2005-2014)
Household Growth	12.6	14.6
Second / Vacation	2.9	1.5
Replacements	2.5	3.3
TOTAL	18.0	19.5

Source: JCHS tabulations of 1995-2005 American Housing Survey (AHS) and the U.S. Department of Commerce Survey of Expenditures for Residential Improvement and Repairs

While the housing market is dismal now, long-term prospects are favorable according to experts.



Source: National Association of Home Builders and JCHS

Experts Forecast Green Days Ahead



The graphics above show the many benefits of building green, including energy savings.

Green building was a topic of excitement during an otherwise bleak construction outlook for 2008. When asked, "what's the most exciting thing coming?" most agreed on one topic: "green, green, green," as Susan Kennedy, director of marketing for Sloan Valve Co., said. But that's not to say there aren't challenges associated with the green movement.

"For green, the real challenge is in [transforming] existing buildings," said Brad Haeberle, vice president, marketing, for Siemens Building Technologies Inc. "We're just not there."

Shortly after the panel discussion an entire session was devoted to this topic. Rick Fedrizzi, president of the U.S. Green Building Council, gave a green construction outlook for 2008. He said the key to getting buy-in for green buildings is to have a strong business case. For example, focus on items such as tenant retention for green buildings and provide proven facts:

- Students in green schools perform 20 percent better on tests than students in other schools;
- Patients in green hospitals are leaving two and a half days earlier than patients in other hospitals; and
- Shoppers are more relaxed in green retail stores where factors such as daylighting and improved air quality plays a role, therefore they buy more.

"These human performance factors are the smoking gun when it comes to building green," said Fedrizzi.

While many may think building green has high costs, he quickly debunked this myth.

"The number-one mistruth is that it costs more to build green. There is study upon study that

proves that for the first two levels of LEED a building can be constructed for not a penny more," he said. "A \$4 investment in building green nets a \$58 benefit per square foot over 20 years."

He also pointed out that LEED buildings can reduce carbon omissions by 40 percent. "This is what it's all about," he said.

"We are in the midst of the biggest societal shift since World War II ... We're humans. We want to address these problems. We don't want to leave a legacy of filth," he added.

Growth in green construction is anticipated. The tipping point, Murray said, is expected to come in a market shift over the next three years. By 2009, 80 percent of corporate America is expected to be engaged in green activities at least 15 percent of the time, and 20 percent will be engaged in green activities 60 percent of the time.

Representatives from the door industry already are involved in providing green products.

"Environmental issues help to reinforce the ongoing steps our organization is involved with concerning the national focus on sustainable design and projects," said Tim Petersen, national sales manager, architectural wood doors, for VT Industries.

Sandy McTavish, vice president of manufacturing for Harring Doors, agreed, saying he took a lot from the green presentation.

"Green requirements are showing up in a lot of specifications right now," he said. "Whether we get the job or not it gets our name out there [that we provide green products]."

Courtesy of USGBC.



Fedrizzi captured attendees attention by comparing a nutrition label to what could be done with a LEED label.

ANOTHER VIEW: Housing Market to Bottom Out, Turn Next Year

While experts at the conference don't predict a housing turnaround in 2008, economists who participated in the National Association of Home Builders (NAHB) Fall Construction Forecast Conference on October 24 disagree. They expect the industry to bottom out and to start turning around in 2008.

Experts acknowledge that there is definitely downward momentum in the market at this time. Starts, sales, prices and permits are off, and problems in the subprime and Alt-A mortgage markets, NAHB chief economist David Seiders said that housing should nevertheless begin a modest recovery next year.

Despite the present market contraction, Seiders said that housing should begin to look up next year for a number of reasons: the overall economy and job growth continue to move ahead at a decent pace, core inflation is under control, the late-summer credit crunch in mortgage markets is showing signs of easing since the Federal Reserve cut short-term interest rates on September 18 and the supply-demand equation will be better balanced as builders begin to whittle down excess inventories.

It is this issue of excess inventories upon which experts at both conferences agree. With the housing sector facing a large backlog of unsold inventory, Seiders said that starts and permits won't begin to move forward until sales firm up.

"Home sales should bottom out by the end of the first quarter of 2008, and I have starts up in the third quarter of next year, assuming the inventory overhang stabilizes," he said.

Following are some other predictions offered by Seiders:

- NAHB is forecasting 828,000 new single-family home sales for 2007 and 781,000 next year, a 5.6-percent decline.
- Total housing starts are expected to register 1.363 million in 2007 and 1.2 million next year, an 11.9-percent decline according to NAHB projections. Single-family starts, Seiders said, are expected to show a 50-percent decline

from their peak in the first quarter of 2006 to a trough in next year's second quarter.

Maury Harris, managing director and chief economist at UBS Investment Bank, agrees, saying he sees "housing bottoming out in the first half of 2008 and starting to pick up in the second half of the year."

The last time a housing recession was this serious was in the mid-1960s, Harris said, but the big difference between then and now is that "the Fed is not dealing with inflation."

If something does halt a recovery Harris said it will be the 500,000 foreclosures on subprime and Alt-A loans both this year and next.

"The foreclosures aggravate the inventory situation and weigh on the market more than in past cycles," he said.

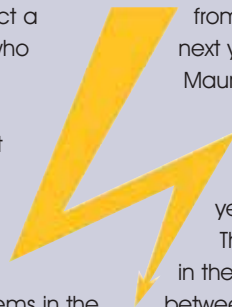
However, Michael Moran, chief economist for Daiwa Securities America Inc., said that the mortgage picture is not as bad as it looks.

"Twenty percent of the subprime market is under stress," said Moran. "Twenty percent of 13 percent is less than 3 percent of the total mortgage market. The economy should absorb this shock."

As for the high number of foreclosures expected this year and next, Moran said the economic fallout will not be as severe as many analysts anticipate because the vast majority of the affected homeowners made little or no down payment on their houses and will walk away without much of a loss.

While there may be disagreement on a few issues experts seem to agree that the housing picture looks much better in 2009.

"By the end of 2009, we may be at a pace of 1.5 million units of new housing production (including manufactured homes). Once we are out of the woods, we should see good growth in front of us—maybe 2 million per year," said Seiders.



"Twenty percent of the subprime market is under stress."

—Michael Moran,
Daiwa Securities America Inc.

Although the remodeling market has almost doubled since 1995, there is concern for this segment as well, including:

- A broader residential downturn shows no signs of reversing: home sales are declining and home prices are falling;
- The practice of turning house equity into cash is slipping after very strong growth;
- Remodeling contractors have high failure rates during downturns;
- The share of cost recouped on remodeling projects has been declining. "That has finally gotten homeowners' attention," said Baker.

But again, the long-term outlook is positive.

"Once the housing market stabilizes remodeling will go up," he said.

Baker also enumerated some remodeling trends, based on findings from an AIA design trends survey. He said energy-efficient and low-maintenance products are valued when homeowners select products and added that this includes "triple-glazed windows."

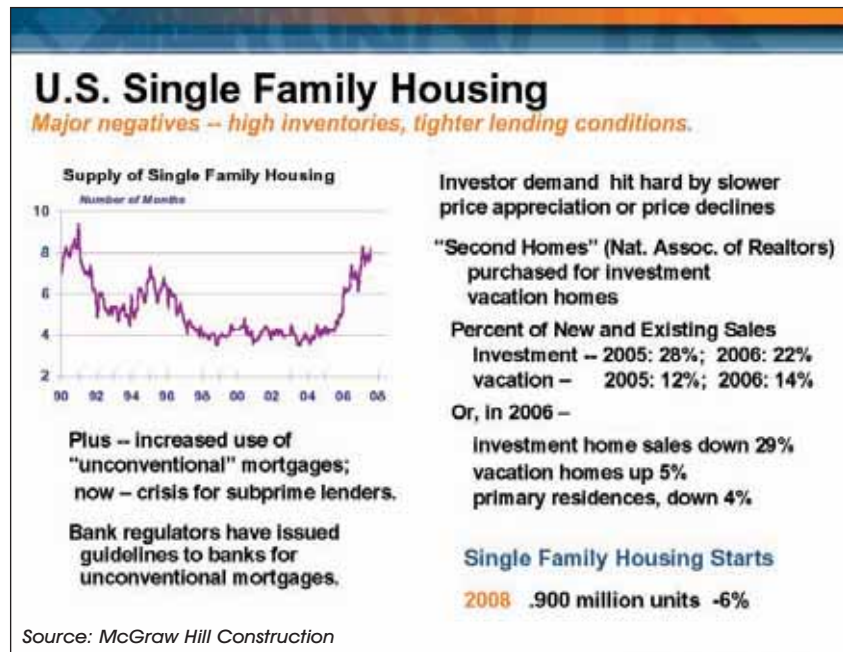
And he ended his forecast with more good news: "It's an industry that has a strong upside in the coming decade."

Commercial Construction

While the last few years have seen a dip on the residential side, commercial construction has seen an upturn. But Murray says that is starting to change.

Overall, Murray is predicting commercial building construction starts to drop to \$91.1 billion from a total of \$97.3 billion in 2007.

"The credit crunch that emerged



Experts agree that high inventory levels must come down before the housing market gets back to normal.

The Crystal Ball

	2006:4	2007:3	2007:4	2008:4
Steel Structurals (\$/st)	655	760	753	631
%CHYA	14.2	16	15	-16.3
Rebar (\$/st)	514	583	561	527
%CHYA	5.6	9.3	9	-6
Copper (LME, \$/mt)	7,067	7,709	7,908	7,227
%CHYA	64.3	0.5	11.9	-8.6
Aluminum (LME, \$/mt)	2,723	2,527	2,457	2,212
%CHYA	31.2	1.8	-9.8	-10
Cement, PPI, June=100	200.9	208.6	207.1	208.2
%CHYA	11.2	4.2	3.1	0.5
Lumber, PPI, 1982=100	166.3	178.5	169.4	164.1
%CHYA	-15.1	-2.4	1.8	-3.1
Gypsum, PPI, June 81=100	245.8	210.2	203.9	179.1
%CHYA	9.8	-18.8	-17	-12.2

Mothersole says collectively pricing is projected to be flat in 2008.

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at mid-2007 continues to be a major concern for construction and the overall economy," he said. "As a result, we're now predicting downturns in the previously resilient multifamily and commercial segments, as well as continued weakness in single-family home construction." (For more on Murray's predictions for the commercial market, see the January 2008 issue of *USGlass* magazine.)

Many in the door and window industries rely on predictions such as Murray's to help them plan for the coming year. For example, representatives from companies such as PPG, VT Industries and Harring Doors attended the conference this year.

"It's important for us to hear about the economy from a national perspective that focuses specifically on the construction industry," said Tim Petersen, national sales manager, architectural wood doors, for VT Industries. "It is useful for establishing baseline sales targets for the upcoming sales year."

Building Materials to Remain Relatively Flat

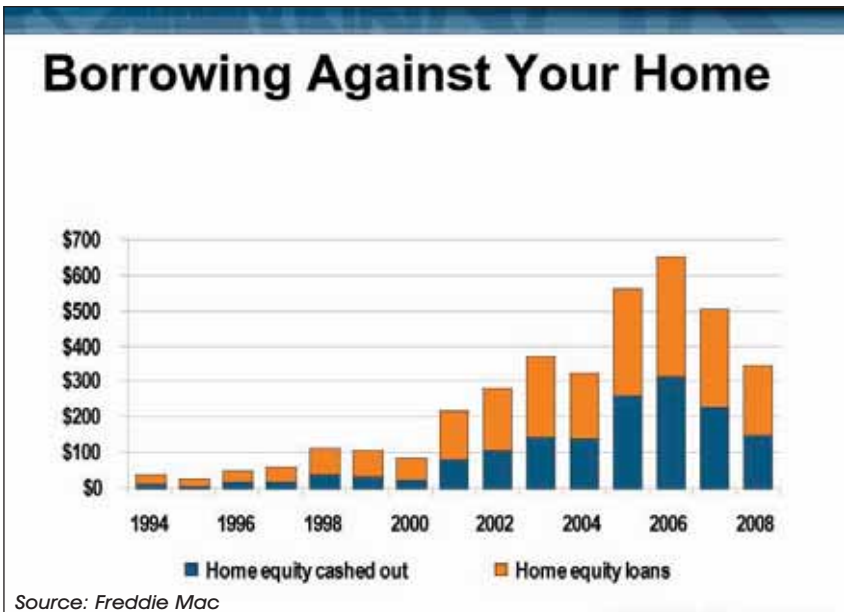
John Mothersole of Global Insight offered his predictions for building materials pricing.

"Collectively, pricing is projected to be flat in 2008," he said. Following are a few key predictions:

- **Lumber:** "The story here is the production cut backs. There is not an oversupply and that will help stabilize market pricing."

- **Steel:** "The next couple of months look problematic. Price increases are coming—they're inevitable."

- **Aluminum:** "Aluminum markets in North America look terrible. Extrusions are even worse. The problem with aluminum is that alloy



Source: Freddie Mac

While the housing market is weak, Wyss says the rest of the economy is growing at a rate of 3 percent.

"This [home inventory levels] is the problem we have to work off until things get back to normal."

—Kermit Baker, AIA

metal prices have been going through the roof."

Economic Outlook: Fair


David Wyss, chief economist for Standard & Poor's, offered his economic outlook and said the U.S. economy has slowed after three strong years.

"Housing is the only major weakness; the rest of the economy is still growing [at a rate of] nearly 3 percent," he said.

Wyss noted that the weaknesses aren't found in the high-priced markets. Rather, the default rates are highest in the Midwest and the South. He said that employment is finally improving, which is helping construction. He did, however, question whether the consumer can keep spending.

"A risk of recession remains if further terror attacks damage confidence, while oil prices soar. Financing problems push the dollar down and U.S. bond yields higher," he told attendees.

This falling of the dollar value has some companies like Canadian door manufacturer Harring Doors concerned.

"As a Canadian manufacturer who sells into the United States, the presentations given confirmed that the dollar will decline, which won't help us," said Sandy McTavish, vice president. 



by Tara Taffera,

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