



MADISON'S TIMBER PREVIEW

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May 04, 2012

On Thursday, May 3, Reed Construction Data held an **Economic Construction Forecast Webcast** titled, "*A Construction Recovery at Last—but How Long and How Strong?*"

The webcast featured leading construction industry chief economists: Kermit Baker of the American Institute of Architects; Bernard Markstein at Reed Construction Data; and, Ken Simonson of the Association of General Contractors, in an analysis of likely future activity within the various construction sectors.

Markstein started the webcast off with a brief background on the general economy.

"Economic growth is subpar but improving," said Markstein. "The US economy did have a setback in 1Q 2012, real GDP growth was only 2.2 per cent. So far the US has not really seen too many periods of sustained growth, which is necessary for employment to improve.

"Inflation has been creeping up, which is a good sign because it is within acceptable levels. Energy prices are slacking off now so we will probably see more improvement."

Next, Baker presented the latest data on new construction and on home improvement rates in the US.

"Our information reflects business conditions at architecture firms," Baker began. "The rate of home improvements didn't drop as far during the downturn so have had a stronger base to build off. Home improvement spending peaked in 2007, hit a trough in 2010, then saw modest gains in 2011. Generally speaking, remodelling accounts for 30 to 45 per cent of total spending on the housing market but in 2009 it accounted for 70 per cent, and maintained that rate in 2010 and 2011.

"Many of the distressed homes currently bogging down the housing market have been empty for a long time, and need work by the lender before they can go on the market. In 2011, one million previously-foreclosed homes were put on the market, 37 per cent of which needed repairs. The average cost per unit was US\$6,200, for a total investment by lenders of US\$2.3 billion. In terms of post-sale figures, 57 per cent of the 1.5 million homes bought last year underwent remodelling of some kind, at an average cost per unit of US\$7,330, for a total of US\$6.2 billion. That brings the total for 2011 remodelling in the US to between \$8 and \$9 billion. We expect to see this activity improving, especially in the second half of 2012."

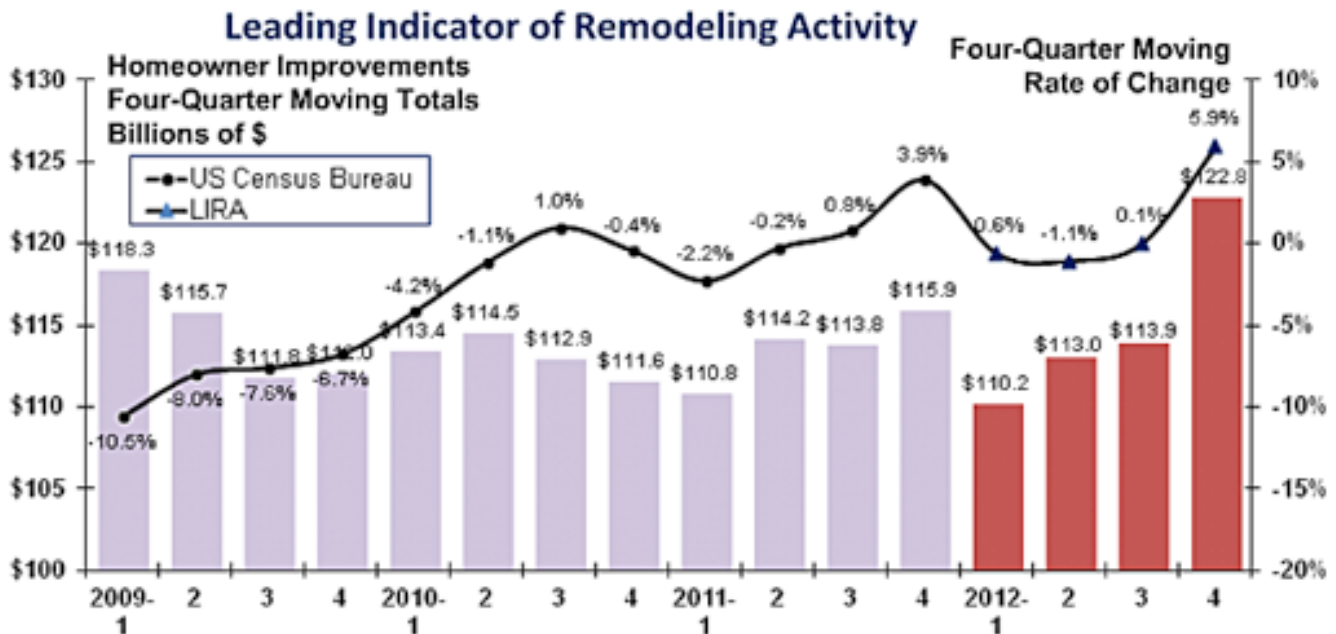
"House prices remain weak, at levels not seen in history," continued Baker. "The drop in price of not-distressed properties was less severe, at a 25 per cent, than distressed properties, which lost between 35 and 40 per cent of their value. The inventory of unsold homes is still affecting appraisals, will bring downward pressure on house prices. The appraisal process is making things more complicated, it seems appraisers are being very conservative. A buyer and seller will agree on a price, then the bank will hire an appraiser who comes back with a much lower figure thus the bank nixes the sale.

"Household formations have been very low, what with children and parents doubling up, people moving in with friends, and people turning to renting. In 2003 to 2005, there were 1.5 million annualized net new households, most of which were owners. In 2007 to 2009 that number was 0.5 million, with a dramatic shift to renters.

"At the end of 2011, the national home ownership rate in the US fell to 66 per cent, from 69 per cent. In 1Q 2012, it was barely at 65.6 per cent, the lowest figure in 15 years, and I think home ownership rates

will go even lower as foreclosures continue. Just to be clear, the time a home is most likely to undergo improvements is around a sale. Less home sales means less improvements.

"For five straight months, architecture billings activity has been above 50, but just barely, so there is modest growth," concluded Baker.



"We have seen more good news lately than in the past several years," started off Simonson. "There are still problems with the building of new office and retail space, single-family housing starts are still a question, but new apartment building is doing well, as is power plant, manufacturing, warehouse/distribution, and hospital building.

"The cost of construction materials is up 16 per cent over the bottom in March of 2009. We do expect to see a somewhat weaker 2012 due to slower growth in China plus some countries in Europe seem to be in recession. Given that, we expect to see less volatility, and another 5 to 6 per cent increase in building material prices [including lumber and panel] by the end of the year, just as we did at the end of 2011 and 2010.

"We also expect to see residential construction spending increase by 5 to 15 per cent within the next year," concluded Simonson.

Next the moderator allowed questions from the floor.

In his introduction, Bernard Markstein had mentioned that Washington, DC, has exhibited an inability to reach a compromise on important issues which have an impact on construction. For his part, Kermit Baker expressed concern that ongoing policy issues are creating uncertainty in the housing market, that people are looking for pricing stability.

Listeners jumped all over these comments, asking numerous questions, particularly about the ongoing debt ceiling votes. The panelists were all in agreement: the lack of consensus in Washington is very discouraging, and is being made even worse by the fact of an election year. One panelist said that "in Washington, compromise seems to have become a four-letter word."

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