BIG BENUZZI'S INDUSTRIAL GUIDE

VOLUME 8, NO. 1 Your BIG Chicago Area Industrial Real Estate Resource Guide JANUARY 2011

Improved Commercial Construction Forecast Anticipated for 2011

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The "stalled recovery" is a term that has frequently appeared in numerous economic and construction industry forecasts. It's a term that's reflective of the 18-month time that has passed since the 'official' end of the recent economic recession (June 2009) that has demonstrated little "recovery". Since it's historically the housing market that leads the nation out of its past recessions, this time the modest 6% gain in the housing market recorded in 2010 did little to nudge the numbers above historical record-breaking lows. In fact, 2010 recorded the second lowest level of overall construction activity on the books since the recording of this statistic began in 1958 – not surprising, the year 2009 stands as the lowest recorded volume on record for the single-family housing market.

There have been a number of positives and an equal number of negative factors that have effectively left us 'standing in place' even this far into the anticipated economic recovery timeline. The hold backs have included the meager resuscitation of the residential housing market in 2010. Analysts had originally anticipated the housing market to rebound by 30% in 2010 but the industry barely scraped by with a lackluster 6% uptick. That the housing market improved at all is a surprising statistic but there are pockets of activity within the Sunbelt and West Coast markets even as the Chicago area continues to suffer from depreciation, lack of activity and virtually no new housing construction.

The non-residential markets were also restrained from expanding due to the continued stagnant growth in the job market. Commercial markets are also slowly absorbing the significant volumes of existing space that was either never originally leased or spaces that have been vacated by corporate victims of the economy. The constrained lending conditions have also contributed toward the absence of activity in the commercial markets while developers and owners strategize on how to overcome the increasing demand for more equity and shorter loan terms from the banks.

The massive amounts of federal spending that represented the U.S. government's stimulus package did little more in 2010 than to bolster certain public works projects by a mere 2%, according to McGraw-Hill Construction's estimates.

Looking Ahead to 2011

There are several signs that may indicate a slight improvement in construction activity for 2011. It would be prudent to consider the next 12 months as a time of transition from the declining levels of the past two years to the growth,

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although modest, that is anticipated for 2012. Weighing heavily on the potential of that positive turnaround in 2012 would be factors such as the continued rate of high unemployment, tight credit and the potential for political gridlock in Washington. McGraw-Hill Construction has courageously ventured forward with a positive outlook for 2012. In that recent construction forecast report, McGraw-Hill Construction predicted that U.S. construction starts will increase to $445.5 billion in 2011. The 2011 anticipated increase follows the estimated 2% decline that is likely to be reported for 2010 which was almost negligible compared to the 24% drop in construction volume that was recorded in 2009.

An anticipated increase of 25% in the construction of commercial buildings (healthcare, education, warehouse/distribution and other general categories within the construction industry) is anticipated this year, following the industry's 10% decline within this segment in 2009. For commercial developers and contractors, it may take until 2012 to see the improvement taking shape.

It's predicted that more than 25% of the growth anticipated in 2012 is expected to occur in single-family housing. This housing rebound would then potentially spur additional growth in other commercial markets that have also realized sizable drops in volume over the past two years. The report anticipates a 13% increase in office building work in 2011, a market that realized a steady decline of 23% in 2010. An equal improvement in the hotel and recreational markets is expected to reach 13% in 2011 following the sharp 31% decline recorded in 2010. With the recent reports of a positive 6% increase in retail sales over the holiday season, it's not surprising that a 14% increase in stores and shopping center construction is anticipated for 2011 following the sharp 7% decline experienced during 2010.

Reality Check

Before we get carried away by the anticipated positive gains within the above markets, it's important to remember that it's often not difficult to achieve double-digit gains when the starting points begin at such low numbers. In terms of volume, many of these markets are simply moving from their worst recorded volume levels to their second worst levels of recorded activity since statistics began in 1960. While several markets are showing forward progress, we're still a long way from returning to our previous levels of economic prosperity.

In comparison, although we're scheduled to experience a 13% increase in office construction in 2011 that will reach approximately 59 million square feet of new building activity, it pales in comparison to the 225 million square feet put-in-place during 2007 and the more than 300 million square feet constructed in 2001. After three years of falling volumes in all commercial construction categories, the uptick in numbers is barely noticeable but represents a welcome change nonetheless.

Going forward, the U.S. Department of Commerce will discontinue its forecast of recording construction put-in-place volumes. This report has been a cornerstone of information within the market allowing fundamental industry projections and statistical analysis of actual activity throughout the national market. Raleigh, North Carolina-based FMI Corp. has announced that it will continue to track that data and make that information available to assist contractors, developers and owners in tracking shifts and anticipated swings in construction volumes and changes within market segments.

The recent report issued by FMI predicts that residential markets will enjoy an 11% increase in 2011 while non-residential markets will decline by 1% for put-in-place work. The forecast also predicts that the total construction volume put-in-place will increase by 5% in 2011 following the 7% decline experienced in 2010 and the double-digit decrease of 15% experienced in 2009.

In FMI's Fourth Quarter Non-Residential Construction Index Report, it's anticipated that there will be slight improvement in certain markets in 2011. Anticipated growth is likely, but will be modest, in select markets such as healthcare, education and within specialty markets such as power and water plants, the

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military, data centers and telecommunications. Randy Jiggard, managing director of research services at FMI remarks, "This is not the kind of recovery that will come bouncing back. It may be five years before the market breaks the trillion-dollar mark again." FMI predicts that 2011 construction put-in-place levels will reach $881 billion compared to $842 billion in 2010.

Another well-respected industry group headquartered in Washington, D.C. – the Associated Builders & Contractors (ABC) – predicts that total non-residential spending will be about 0.1% less than in 2010. ABC's chief economist, Anirban Basu states, "Privately financed construction levels are projected to decline 0.2%, while publicly financed construction levels are projected to be virtually flat."

Material Price Uncertainty

The market is also under price pressures on certain globally-traded commodities. As Ken Simonson, Chief Economist for the Associated General Contractors of America (AGC) reported, "Material prices, which had been well behaved for nearly two years, have started to act up – with emphasis on UP." Materials such as copper and steel (particularly scrap that forms the raw material for most construction steel) together with oil have a higher rate of price spikes than materials that are produced and are in demand within local markets such as lumber, concrete, wallboard and asphalt.

Therefore, some materials may hit new record prices while others may decline in cost. This creates an unpredictable price climate for contractors extending price proposals that have recently enjoyed long shelf lives. Owners are likely to continue to be reluctant to absorb any price increases even with the growing likelihood that increases are predicted for 2011 so contractors need to remain alert to the unpredictability in materials costs that is anticipated.

Strategic Advancement

If light is to be found at the end of this very long tunnel, a continued advantage of the slowed economy is that it has allowed businesses within this industry to focus on certain business practices that will provide longevity, creativity and better utilization of resources. The recession has forced us to re-examine our diversification strategies and to research areas that can provide added opportunities for new assignments. It's forced us to retrench and be honest about the true strengths and weaknesses of our respective businesses and to align our employees together into stronger teams united toward a common goal.

We also learned how to be better 'fishermen' as we've skimmed every shallow creek bottom and small pond to locate that next construction or development opportunity. In fact, each employee is now entrenched into supporting and contributing toward the business of obtaining new business as they process less volumes of work put-in-place in lieu of 'obtaining' work to put-in-place. We have also been challenged to conduct some soul searching and research on not what we want to be doing or selling – but in understanding and formulating services and capabilities that our clients wish to buy. That insightful strategy will result in a more strategic implementation of our resources and talents in the years to come as we re-engineer our companies again enjoy the rewards available within the real estate and construction industries.

We may be down right now but we're definitely not out. Let's continue to fight through the remaining throes of this economic downturn in order to become more efficient, increasingly insightful and offer greater resiliency in growing our businesses and providing services and projects to the satisfaction of our current and future clients.

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