

**UHERO Construction Forecast:**

# **Surge in Nonresidential Building Sustains Cycle**

by

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## EXECUTIVE SUMMARY

### Key Changes in This Forecast.

- Growth in real nonresidential building permits surged ahead at the end of 2006, ending the year \$500 million higher than expected. Our 2007 forecast of a 9.5% decline is in line with our previous forecast, but the predicted level of real nonresidential permits is \$400 million higher than previously expected.
- Largely on the strength in nonresidential construction, we now expect real contracting receipts to grow by 4.4% in 2007. With the exception of the decline in residential construction, the overall slowing trend has been pushed back by one year.
- This report is our first to include forecasts of a median condominium resale price for O‘ahu.

Hawai‘i’s construction cycle is near or past its peak, depending on which sector you look at. While the homebuilding peak occurred in 2005-06, the peak in nonresidential construction is likely in 2007 or 2008. The end of this cycle will be characterized by a slow decline in total real construction spending, but continued increase in the nominal tax base as construction costs rise between 4% and 5% each year. With home price appreciation over and affordability at recent lows, real residential construction will continue to recede gradually. At the same time, nonresidential elements of construction will be relatively stronger, and the overall outlook continues to be one of gradual slowing. Despite a slow decline from their expected peak in 2007, construction employment and earnings will remain above 2006 levels for the next several years.

- Unlike the end of previous residential construction cycles—often helped along by rising long-term interest rates—the current downturn is really about the exhaustion of affordability brought about by the more than doubling of home prices since 2000.
- After four years of double-digit percentage increases, the probability of above average returns to housing faded and the 2005 slowdown in Hawai‘i home price appreciation turned into stagnation in 2006. We expect the median single family resale price on O‘ahu to decline by a little over 3% in 2007 before resuming slow growth towards \$616,000 in 2008.
- As investors look elsewhere, and with developers’ upside increasingly bound, real residential construction will continue to decline. After a drop of 27% in 2006, constant dollar residential permits will fall by almost 13% in 2007 followed by a gradual decline towards \$1.3 billion in 2008.
- The 45% growth in real nonresidential permits in 2006 is unlikely to continue, and commitments are expected to fall by 9.5% in 2007 before stabilizing near \$1.4 billion in 2008. While substantially lower than the record set in 2006 of \$1.78 billion, nonresidential permits are expected to remain almost 40 percent higher than in the previous five years, and higher than the level of constant dollar residential permits.
- We expect real government construction contracts to continue in the range of \$700-800 million annually during the forecast period.
- With residential building slowing, and nonresidential and to a lesser extent government activity taking up the slack, total commitments to build are expected to decline slowly over the next several years. By 2008, the value of total commitments is expected to settle near \$3.5 billion in constant (2005) dollars.

- The acceleration in construction costs experienced over the past several years will continue in 2007, with costs rising 8.7%. Construction cost inflation will subside to a more moderate 5% rate in 2008.
- In constant (2005) dollars total contracting receipts grow by more than 4% in 2007 followed by a decline of more than 3% in 2008 as construction costs outpace nominal spending.
- The increase in real construction activity—for one more year—will support some additional gains in the construction job count. From 35,880 construction jobs in 2006, our forecast calls for payrolls to grow 3% this year to 36,930. After that, the contracting job count will decline slowly towards 36,430 jobs in 2008. The expected increase in construction jobs to just under 37,000 in 2007 exceeds the previous record set in 1991.

#### HAWAI'I CONSTRUCTION FORECAST (SUMMARY)

	2004	2005	2006	2007	2008
Nominal GE Contracting Tax Base (Mil \$)	4,922	5,851	6,970	7,903	8,030
<i>% Change</i>	8.49	18.89	19.13	13.39	1.60
GE Contracting Tax Base (Mil 2005\$)	5,283	5,851	6,343	6,619	6,390
<i>% Change</i>	2.89	10.75	8.41	4.36	-3.47
Construction Job Count (Thou)	29.40	33.40	35.88	36.93	36.43
<i>% Change</i>	5.22	13.61	7.44	2.93	-1.36
Construction Income (Mil 2005\$)	2,369	2,725	2,856	2,940	2,919
<i>% Change</i>	4.95	15.04	4.81	2.95	-0.71
Honolulu Median Home Price (Thou \$)	457.15	586.53	632.03	610.90	615.61
<i>% Change</i>	20.93	28.30	7.76	-3.34	0.77
Honolulu Median Condominium Price (Thou \$)	206.93	266.67	310.25	321.22	317.80
<i>% Change</i>	19.13	28.87	16.34	3.54	-1.06

\* Tax base is deflated by Honolulu Construction Cost Index. Income is deflated by Honolulu CPI. Additional detail available to subscribers and sponsors.

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