

UHERO Annual Hawai'i Construction Forecast:

Despite Credit Concerns, Soft Landing Expected

by

Carl S. Bonham
UHERO

Paul Brewbaker
Bank of Hawaii

Research assistance by
Somchai Amornthum and
Porntawee Nantamanasikarn

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University of Hawaii
Economic Research Organization
2424 Maile Way, Room 542
Honolulu, Hawai'i 96822
(808) 956-7605
uhero@hawaii.edu



**University of
Hawai'i
Economic
Research
Organization**

EXECUTIVE SUMMARY

Despite concerns related to recent financial market turmoil, Hawai'i's construction industry still appears to be poised for a soft landing. Growth in real contracting receipts will slow in 2007 and turn negative in 2008–09, with hotel renovation and industrial and commercial construction providing a stabilizing influence in the face of a steadily weakening residential sector. The construction job count is expected to peak in 2008 and decline only slightly in 2009. While real construction spending will turn downward, the nominal tax base will continue to rise as construction costs push up nominal values. While there are currently no signs of a significant and prolonged downturn in Hawai'i's construction sector, any further worsening in the availability or cost of credit will adversely impact this forecast.

- At least since 2005, construction activity has confronted a squeeze play due to rising construction costs and the increasing unaffordability of Hawai'i homes. More recently, turbulence in financial markets has focused attention on the increasing cost and decreased availability of credit.
- Construction costs have risen rapidly in the past several years driven by global spikes in prices of energy, metals and building materials rather than any significant increase in labor costs. As global commodity markets stabilize, and the rapid world wide expansion of building activity of the 2004–5 period subsides, we expect construction cost inflation to slow steadily from 8 percent in 2007 to between 4 and 5 percent in 2008–09.
- The 2006 median resale price of O'ahu single-family homes—\$632,000—was 1.6 times the calculated affordable price of \$386,000. As incomes rise, the affordable price will steadily inch upward, but even with a flat home price forecast, the affordability ratio will only slowly decline to 1.5 in 2008–2009. This persistent unaffordability is a big reason why homebuilding is forecast to continue to slow, bottoming out in real terms in 2009.
- This summer's market break severely disrupted channels through which non-bank intermediaries funded residential and nonresidential mortgage lending and construction financing. While banks continue to have adequate liquidity, the non-bank intermediaries have seen credit spreads widen dramatically, increasing their costs of funds. In at least one important funding channel, the market for short-term (30-day) commercial paper, liquidity has all but dried up. The financial fall-out from these liquidity constraints is still unfolding, but it appears inevitable that many sources of credit important to Hawai'i construction and real estate financing are impaired.
- Residential construction commitments for new home building peaked in 2005 at \$2.48 billion, soon after the turning point in existing home resales. After a drop of 27% in 2006, constant dollar residential building permits are forecast to decline 4.2% this year followed by a double digit drop in 2008.
- Nonresidential construction commitments continued rising through the end of 2006. In current dollars, permits for commercial buildings reached \$732 million last year, while permits for additions & alterations reached \$1.23 billion. In constant 2006 dollars, nonresidential construction will dip from \$1.96 billion in 2006 to \$1.70 billion in 2007 and hover near \$1.63 billion for next several years.
- Total private building permits, which topped out at \$3.77 billion in 2006 (adjusted for inflation), are forecast to settle to \$3.44 billion during 2007, down 8.9 percent.

- Government construction contracts continue to be dominated by federal military housing-related construction along with transportation, water and wastewater management outlays by both state and county governments. We expect constant-dollar government contracts to remain relatively stable in the 850 to 900 million dollar range for the next several years.
- The increase in real construction activity—as measured by total contracting receipts—will support some additional gains in the construction job count. From 35,880 construction jobs in 2006, payrolls are expected to grow 5% this year and rise by 1% to 38,120 in 2008.

HAWAI'I CONSTRUCTION FORECAST (SUMMARY)

	2004	2005	2006	2007	2008
Nominal GE Contracting Tax Base (Mil \$)	4,922	5,851	7,019	7,984	8,340
<i>% Change</i>	8.49	18.89	19.97	13.74	4.47
GE Contracting Tax Base (Mil 2006\$)	5,806	6,430	7,019	7,392	7,344
<i>% Change</i>	2.89	10.75	9.17	5.31	-0.65
Construction Job Count (Thou)	29.40	33.40	35.88	37.74	38.12
<i>% Change</i>	5.22	13.61	7.44	5.18	1.00
Construction Income (Mil 2006\$)	2,507	2,885	3,004	3,202	3,232
<i>% Change</i>	4.95	15.08	4.13	6.60	0.93
Honolulu Median Home Price (Thou \$)	457.15	586.53	632.03	638.16	634.15
<i>% Change</i>	20.93	28.30	7.76	0.97	-0.63
Honolulu Median Condominium Price (Thou \$)	206.93	266.67	310.25	326.36	323.97
<i>% Change</i>	19.13	28.87	16.34	5.19	-0.73

* 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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