

UHERO Hawai'i Construction Forecast Update:
Slow Decline But No Contracting Crunch

by

Carl S. Bonham
UHERO

Paul Brewbaker
Bank of Hawaii

Research assistance by
Somchai Amornthum and
Heber Moulton

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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

Key Changes in This Forecast.

Compared with our Annual Hawaii Construction Forecast released in September, 2007, we have lowered our home price forecast by about \$16,000 in 2008 and roughly \$40,000 in 2009.

We now expect the level of nonresidential permits to settle in the \$1.6 billion range, measured in 2007 dollars. This is about 5 percent lower than our forecast made six months ago.

We have revised downward our forecast for total construction spending to show a real decline of almost 2 percent in 2008, and 4 percent in 2009.

While the external environment has become decidedly more risky since last fall, this forecast makes only a small downward revision to the forecast path. The declines that have occurred since 2006–2007 in residential and nonresidential permits signaled the turn of the Hawai'i building cycle, and real construction spending will decline slightly this year. Construction employment and income will slow to very small positive gains this year, before turning negative in 2009. Some downward drift in home prices will occur, but Hawai'i will avoid the large-scale contraction that is occurring in many mainland cities that must work off home price bubbles. The overall construction cycle will continue to be stabilized by relative strength in nonresidential segments of the industry.

- Hawai'i's residential construction slowdown has been moderate compared with the sharp downturn in homebuilding at the national level. There has nevertheless been a significant decline in private residential permits, with the number of units down 29 percent from the 2005 peak. There have been somewhat larger losses on Maui and the Big Island, which have been affected by a withdrawal of offshore investment.
- Declines in home prices are now widespread across the country. In contrast, O'ahu median single-family home prices were about 1 percent higher in the fourth quarter of 2007 than a year earlier, although down from a mid-year peak. Markets were softer in 2007 on the neighbor islands. Maui saw median single family home prices drop almost 10 percent, while Hawai'i island and Kaua'i prices were off by a little more than 5 percent. Statewide resale volume last year fell to about 14,300 units last year, a decline of 13 percent from 2006.
- We expect the median single-family resale price on O'ahu to decline by a bit more than 3 percent in 2008, and by 2 percent in 2009, but remaining in the \$600,000 range. Persistent unaffordability, slowing aggregate employment growth, rising construction costs, and the increased costs of financing will act as a brake on residential construction. After dropping 5 percent in 2007, constant dollar residential permits are expected to decline about 12 percent in 2008 and 10 percent in 2009.
- We have seen considerable growth in commercial permits in recent years, linked to retail development, resort building and renovation, and demand for industrial space. Softer economic conditions, credit concerns and some Neighbor Island regulatory backlash will restrain growth going forward. We expect a moderate decline in statewide real nonresidential permits of 4.4 percent this year, followed by a less than 2 percent drop in 2009. Over the next five years, the level of permits will stabilize in the \$1.6 billion range, measured in 2007 dollars.
- Growth in government contracts slowed during 2007, declining by nearly 6 percent in real terms. Despite increased financing costs and the slowing of state and county revenues, we expect constant-dollar government contracts to rise from \$870 million in 2007 to near \$1 billion for the next several years.

- Construction costs have surged in recent years because of sharply higher oil and building material prices. Costs rose another 8 percent in 2007. We expect a deceleration in construction cost inflation over the next several years, with costs rising by 5.9 percent in 2008 and 4.4 percent in 2009.
- Total current dollar building authorizations declined by 3.7 percent in 2007, but they were down a much larger 11 percent after adjusting for the effect of rising costs. While the mix of activity is changing, we expect total real permits of \$4.3 billion this year, measured in 2007 dollars, down less than 4 percent from last year. The decline in permitting is expected to continue in 2009, with total real permits declining nearly 5 percent.
- Fueled by work in the pipeline from strong 2006 permits, total real contracting receipts were up by almost 4 percent through the third quarter of 2007, while current dollar receipts grew by more than 12 percent. We expect real construction spending to decline by almost 2 percent in 2008, and 4 percent in 2009. In nominal terms, the contracting tax base will grow for just one more year in 2008 before slowing to zero growth in 2009.
- The momentum in construction job growth continues to surprise, with jobs rising by 5.6 percent during 2007. While permits turned down in 2005, job growth has continued to rise, albeit at a slower pace, possibly because of hiring for military housing renovation projects for which permits are not required. We expect contracting jobs to see one more year of very limited growth in 2008 before declining toward 37,600 jobs by 2009.
- We continue to characterize this as a “soft landing” forecast, but downside risks of further worsening in national credit conditions or a markedly weaker state economic outlook have clearly increased since our last forecast.

HAWAI'I CONSTRUCTION FORECAST (SUMMARY)

	2005	2006	2007	2008	2009
Nominal GE Contracting Tax Base (Mil \$)	5,851	7,018	7,741	8,054	8,059
<i>% Change</i>	18.89	19.95	10.30	4.05	0.06
GE Contracting Tax Base (Mil 2007\$)	6,938	7,573	7,741	7,605	7,292
<i>% Change</i>	10.74	9.16	2.22	-1.76	-4.11
Construction Job Count (Thou)	33.40	35.88	37.89	38.20	37.61
<i>% Change</i>	13.61	7.44	5.60	0.82	-1.55
Construction Income (Mil 2007\$)	2,997	3,105	3,303	3,310	3,276
<i>% Change</i>	14.29	3.62	6.36	0.22	-1.03
Honolulu Median Home Price (Thou \$)	586.53	632.03	639.42	618.95	605.01
<i>% Change</i>	28.30	7.76	1.17	-3.20	-2.25
Honolulu Median Condominium Price (Thou \$)	266.67	310.25	324.79	321.58	312.57
<i>% Change</i>	28.87	16.34	4.69	-0.99	-2.80
Honolulu Housing Affordability Index	60.93	56.28	57.52	68.83	71.10

* Tax base is deflated by Honolulu Construction Cost Index. Income is deflated by Honolulu CPI. Housing affordability index is the ratio of median family income to qualifying income for a loan for the median-priced home (times 100). Additional detail available to subscribers and sponsors.

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