The Carrot and the Stick

BY JOHN CROSS, P.E., LEED AP

The outlook for 2012 construction activity is far less robust than we were hoping for.

DESIGN AND CONSTRUCTION FIRMS serving the non-residential and multi-story residential construction market have spent the last four years in the proverbial position of the donkey trapped between the carrot and the stick. The carrot is the promise of a future rebound in construction volumes to levels approaching the boom days of 2006 and 2007. The stick is the painful challenge of remaining financially viable during this extended downturn. As 2011 draws to a close, the question on everyone's mind is whether 2012 will be the year that the donkey is finally able to take a bite out of the carrot or continue to feel the sting of the stick.

Regretfully, 2012 will be the year of the stick.

The domestic economy showed some signs of life in 2010 which led to a modest increase in non-residential construction of 5% in early 2011. But as 2011 progressed job creation lagged, GDP growth was anemic, excessive partisanship in Washington discouraged consumers, European debt worries destabilized financial markets and the probability of a double-dip recession grew. The end result was a continued reticence on the part of lenders to support private construction projects, cash-rich corporations to defer construction plans and governmental agencies to cut back on public projects as a Band-Aid approach to balancing their budgets.

The impact on the building construction market for structural steel is that the market will remain stagnant in 2012 with an overall growth rate in the neighborhood of 2%. The only segments of the market that will experience significant growth will be multi-story apartments, where activity is expected to increase from an annual rate of 45 million sq. ft to 52 million sq. ft, and warehouse construction, which is expected to increase from 57 million sq. ft to 67 million sq. ft. The growth in apartment construction is being driven by decreasing vacancy rates resulting from individuals being displaced from foreclosed homes, a drop in the qualification rate for home mortgages and a perception that home ownership is less attractive in today's market. Warehouse construction is being driven by increasing imports as well as the increasing use of Internet-shopping-driven consolidated distribution centers. Large-footprint data centers are also considered warehouse facilities and expected to increase as more data storage moves from on-site servers to cloud-based servers.

Many market sectors including retail facilities, offices, parking structures and religious buildings will remain stable at their already significantly depressed levels during 2012. These market sectors are typically driven by the linked trends of employment and consumer spending. The continuing depressed employment market reduces the demand for office space, and the lack of disposable income lowers retail demand and the ability of donors to support the construction of new religious facilities.

The healthcare market will see an expansion in the construction of community clinics but an offsetting contraction in new hospital construction.

Major market contraction will take place in K-12 schools and governmental buildings that are dependent on public funding. K-12 school construction is expected to dip from 100 million sq. ft in 2011 to 80 million sq. ft in 2012. Government building construction will contract from 34 million sq. ft to 24 million sq. ft.

The net growth in constructed square footage will be an anemic 2%. Because the market share for structural steel framing is not the same for all building types, the shift in the relative size of the various types of buildings will result in a net decrease of 2% in the square footage of steel-framed structures and overall structural steel demand in the building market.

The sting of the loss of opportunity in the building market will be offset in part by continued double-digit growth in the various industrial sectors, which will be discussed in a future article.

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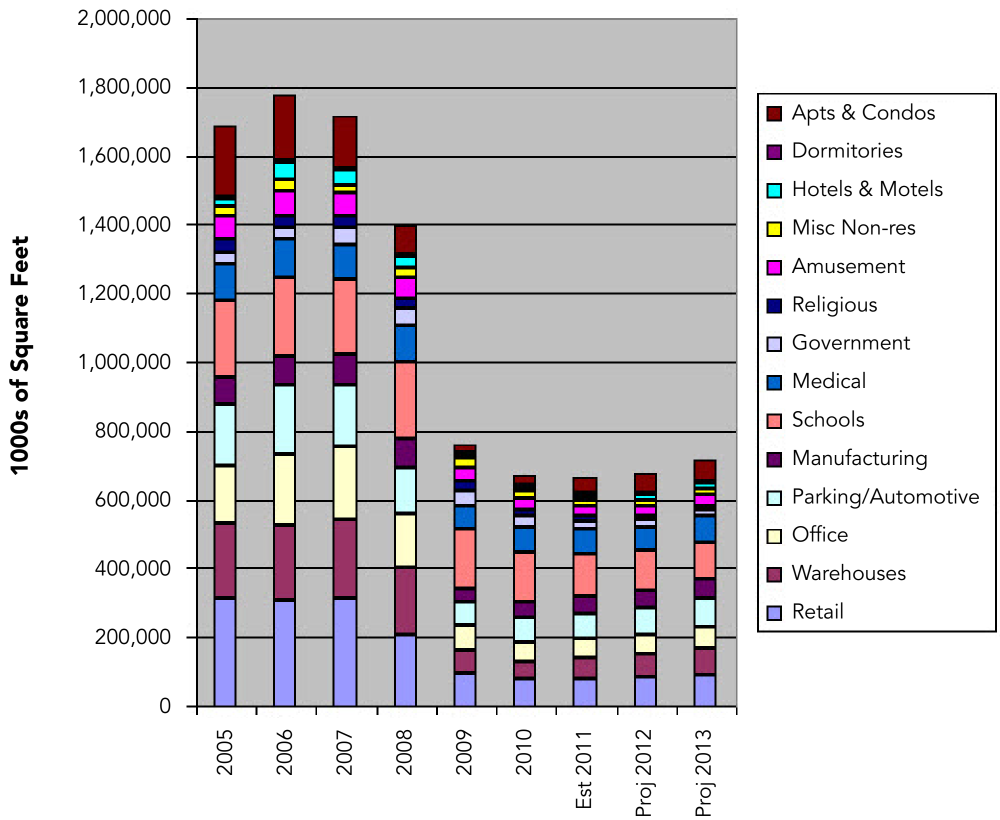

Annual U.S. construction by market segment, with projections for 2012 and 2013.

These projections do not take into account the possibility of a double recession. From March 2011 to October 2011 economists raised the possibility of a double dip from 10% to 40%. If a double dip occurs, building construction volumes in 2012 will experience a dip in the range of 7% rather than grow 2%. However, just-released GDP levels for the third quarter of 2011 and a potential resolution of the European debt crisis now point to a reduced possibility of a double dip.

Will the carrot get any closer in 2013? When does the building construction market rebound to the point where the sting of the stick goes away? The carrot is a long ways away. Even with 2% growth in 2012, the market will still be 62% below the peak of 2006. Initial growth estimates for 2013 vary between 7% and 11%. The next market peak is not expected until 2015 or 2016, and even then the peak of this cycle of building construction will still probably be 20% to 30% below 2006 levels.

The carrot is still out there, albeit smaller than in the past, but we will remember 2012 for the continuing sting of the stick. MSC

How the Current Construction Market Varies By Region

Although non-residential building activity is significantly down from its 2006-2007 peak, the U.S. has never been a homogenous country. Just as different regions of the country prefer different types of cuisine, speak with different accents, celebrate different traditions and express differing opinions, the market for construction varies regionally.

To get a sense of those regional variations *Modern Steel Construction* earlier this fall asked the eight AISC Regional Engineers and two Area Marketing Representatives to share their takes on the climate for construction in their areas of the country. Surprisingly many of them are relatively upbeat regarding new projects and opportunities they see taking shape on the horizon. To read this special online-only report, "A Regional Snapshot," on the *MSC* website, go to **http://bit.ly/sydgoP.**