Economic Environment

Shifting Markets Create Opportunities for Diversified Building Material Suppliers

by Al Schuler

> With single-family housing starts expected to pull back in 2006 and 2007, consider opportunities in other markets, whether you use wood, steel, concrete or other materials.

Since the new millennium began, residential construction has carried the U.S. economy. Record low mortgage rates, innovative financing, a global savings glut and favorable demographics have helped drive housing markets in recent years. And housing strength has been good for most building materials (see ***SBC***, March 2006). However, Figure 1 shows that residential growth has been uneven: the fastest growth has been in single-family followed by renovation markets while multi-family remained relatively flat. During this period, non-residential (NR) construction markets have not performed well.

However, that is expected to change as rising interest rates and high home prices are expected to slow down single-family markets. Because single-family construction accounts for two-thirds of residential expenditures, NAHB expects residential fixed investment (RFI)—dollar value of construction put in place including single-family, multi-family, improvements and manufactured home shipments—to contract over the next two years. This reduction is substantial because RFI averaged almost nine percent annual growth from 2003 to 2005. Therefore, market diversification may be a sound strategy because most analysts expect construction markets to reverse course over the next two years, with solid growth in non-residential expenditures while spending growth on remodeling continues. This will help to cushion the moderation in single-family activity. Manufacturing/industrial markets are expected to improve over the next two years due to the weakening dollar, productivity improvement and a strengthening world economy.

In addition, strong and steady public works combined with rebounding non-residential building markets will help to offset the downturn in new residential construction. Historically, the wood products industry has depended more on the residential market, while non-wood construction materials like steel and concrete have focused on non-residential construction markets. In this issue, we are suggesting that diversification is a good business strategy for component manufacturers whether they be wood based or non-wood based.

Market Outlook for the "Other Markets"

Table 1 on page 22 shows the expected reversal in 2006 construction markets between residential and non-residential with residential expenditures expected to fall by 0.5 percent, while non-residential building expenditures grow by eight percent and non-building construction expenditures by six percent. Through the first quarter of the year compared with same quarter in 2005, the "Year to Date Construction Contract Value" from McGraw-Hill shows total construction up eight percent, led by non-residential building up 16 percent; non-building construction up five percent; and residential building up six percent. Looking further at Table 1, we can see where the more active growth will be in non-residential building markets—office buildings, hotels and motels, other commercial and manufacturing. This turnaround is being driven in large part by the strength in the manufacturing sector (see Figure 2) and the overall strength in the economy.

There are opportunities for innovative component manufacturers to expand their business in steel, concrete and other non-wood materials along with creative use

Continued on page 22

at a glance

- NAHB expects residential fixed investment (RFI) to contract over the next two years.
- Perhaps it is time to diversify: less focus on new residential construction and more focus on remodeling, industrial markets, and non-residential construction.
- To do this, consider getting closer to the end user.

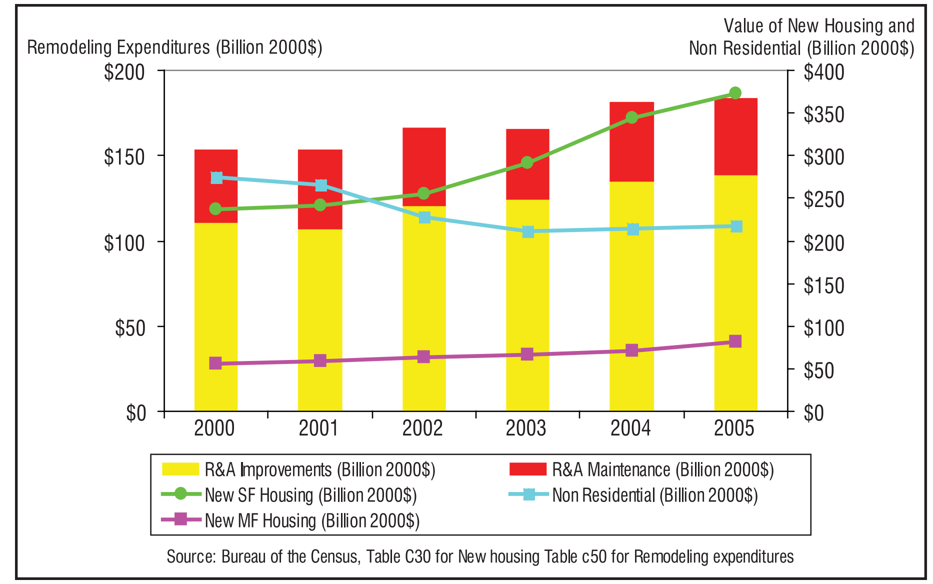

Figure 1. Private Construction Expenditures: Single-family has been the star in construction markets for the past decade.

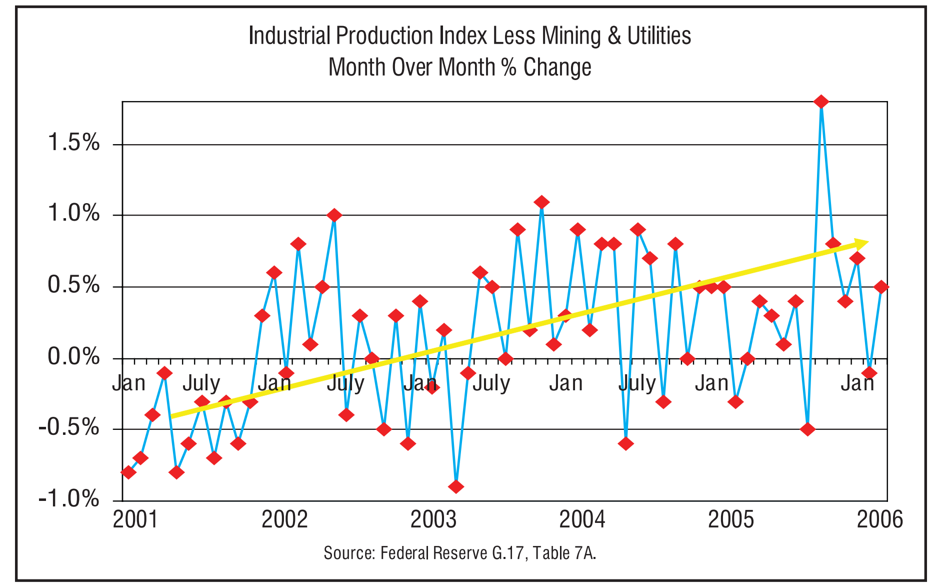

Figure 2. Manufacturing activity continues to gather strength.

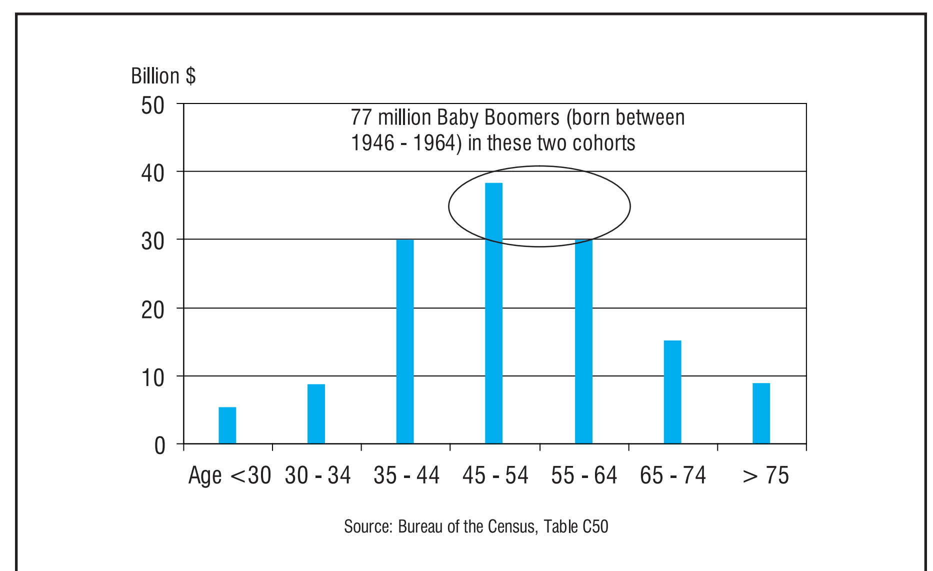

Figure 3. Remodeling Expenditures by Age in 2004: Strong remodeling markets for another decade.

Economic Environment

Continued from page 20

of wood. However, higher energy costs and strong demand are driving inflation in construction costs. Construction managers will be looking for help from their building material suppliers in containing costs. For example, structural steel prices have vacillated between $525/ton and $600/ton for the past 30 months after increasing 40 percent in the first quarter of 2004. Higher energy prices will impact some building materials more than others and with oil prices expected to remain near $60 per barrel throughout 2006, affected industries will need to develop innovative ways to contain building materials cost inflation. In addition, union wage settlements averaged almost four percent in 2005. Through April 2006, McGraw-Hill material costs indexes are up as follows: all materials up 3.3 percent; cement up 7.3 percent; steel up 8.8 percent; and lumber down 5.5 percent.

Type of construction	2005	2006 (Forecast)	% change
Total construction	**636,700**	**654,250**	**+ 2.8%**
Residential	367,575	365,600	- 0.5%
SF	306,200	301,625	- 1.5%
MF	61,375	63,975	+ 4.2%
Non-residential building	**168,625**	**182,150**	**+ 8.0%**
Office bldg	19.3	21.8	12.4
Hotels and Motels	6.9	8.0	17.6
Stores	22.3	22.6	1.1
Other commercial	18.2	20.1	11.0
Manufacturing	7.9	8.6	8.5
Education bldgs	43.1	47.2	9.4
Health Care facilities	20.5	21.9	6.5
Other Institutional bldg	30.5	32.1	5.3
Non-building construction	**100,500**	**106,500**	**+ 6.0%**

Table 1. Value of Construction Project Starts ($ Million). [Source: McGraw Hill Construction, T. Grogan & T. Ichniowski (December 2005)]

Remodeling Markets

Another opportunity is the remodeling market, particularly the improvement category (as opposed to maintenance). The outlook for remodeling is very good based on demographics and the age of the housing stock. Currently, there are about 120 million housing units with a median age of 33 years and nearly 30 percent of these homes are at least 50 years old. In all, 77 million "baby boomers" will spend about $70 billion annually on remodeling projects (see Figure 3 on page 21). In fact, for at least another decade, the largest age cohort in the U.S. population will reach their peak years with respect to remodeling spending.

Summary

What does all this mean for you? Perhaps it is time to diversify: less focus on new residential construction and more focus on remodeling, industrial markets, and non-residential construction. In this way, you might distance yourself from the boom and bust cycles and reduce volatility with your cash flow. Rarely are these markets on the same cycle with respect to new housing.

How should you focus on these markets? That is a topic for a future ***SBC*** article, but here are several points to consider. For each of these markets, getting closer to the end user is more critical than with new housing, where commodity products (and codes and standards) are the norm. However, you can't take homebuilders for granted either as they are demanding better service from their "supply partners." Industrial markets often are a special case because there are fewer codes and standards, and each industrial customer might have different requirements. Professional remodelers often use the same building materials used in new construction. However, most remodelers are small so service and smaller volumes could be an effective marketing strategy. Important in each case is determining how you as a component manufacturer can help these end users solve their problems. The best way to do this is to get closer to them. Business innovation means creating ways to solve human needs and problems. Talking to the end user will help you determine how to become part of their "team," whether you are a manufacturer/supplier of steel, concrete or other building materials including wood. SBC

Al Schuler works for Forestry Sciences Lab in Princeton, WV. Please note that the economic information/opinions contained in this article are not necessarily those of the USDA Forest Service. Dr. Schuler can be reached at 304/431-2727 or aschuler@fs.fed.us. His economic information can also be found online at www.sbcmag.info.

STRUCTURAL BUILDING
COMPONENTS™
THE FUTURE OF FRAMING

www.sbcmag.info

Dear Reader:

The mission of ***Structural Building Components Magazine (SBC)*** is to increase the knowledge of andto promote the common interests of those engaged in manufacturing and distributing of structuralbuilding components to ensure growth and continuity, and to be the information conduit by stayingabreast of leading-edge issues. SBC will take a leadership role on behalf of the component industryin disseminating technical and marketplace information, and will maintain advisory committees consisting of the most knowledgeable professionals in the industry. The opinions expressed in SBCare those of the authors and those quoted solely, and are not necessarily the opinions of any of theaffiliated associations (SBCC, WTCA, SCDA& STCA) .

Truss Publications, Inc.

6300 Enterprise Lane • Suite 200 • Madison, WI 53719
608/310-6706 phone • 608/271-7006 fax
www.sbcmag.info • admgr@sbcmag.info