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Vol. 16, No. 34 · September 12-19, 2016

PPI for new buildings moderate; hiring plans diverge; income properties remain healthy

*Signs of a slowdown in **construction activity** are accumulating but not conclusive. Construction spending and employment have been flat or generally decreasing since March, but remain above year-ago levels. Producer price indexes (PPIs) for new building construction are rising more slowly than in the past several years, suggesting reduced pricing power by contractors. Contractors' hiring plans for next quarter vary by region from "a slight decline" to "moderately stronger." There have been scattered reports of project cancellations because of softening demand or tightening credit. Readers are invited to submit their observations to simonsonk@agc.org and to hear more about the outlook in a WebEd this Wednesday.*

The **PPI** for final demand in August, not seasonally adjusted, decreased 0.1% from July and was flat year-over-year (y/y) from August 2015, the Bureau of Labor Statistics (BLS) reported on Thursday. *AGC posted tables and an explanation focusing on construction prices and costs. Final demand includes goods, services and five types of nonresidential buildings that BLS says make up 34% of total construction. The **PPI for final demand construction**, not seasonally adjusted, was unchanged for the month but rose 0.7% y/y. The PPI for new nonresidential building construction—a measure of the price that contractors say they would charge to build a fixed set of five categories of buildings—rose 0.6% y/y, the smallest y/y increase since 2010. Changes ranged from -0.4% y/y for industrial building construction to 0.1% for schools, 0.8% for healthcare buildings, 1.0% for warehouses and 1.3% for office buildings. **PPIs for new, repair and maintenance work** on nonresidential buildings fell 1.5% y/y for plumbing contractors and rose 0.4% for electrical contractors, 1.3% for roofing contractors and 5.1% for concrete contractors. Many of the building and subcontractor indexes increased at the smallest rate in several years but the rise in the concrete contractor PPI was the steepest since 2009, reflecting ongoing price increases for cement and crushed stone. The **index for inputs to construction**—excluding capital investment, labor and imports—comprises a mix of 59% goods (including 5% for energy) and 41% services (including trade services, 26%; transportation and warehousing, 4%; and other services, 10%). The overall PPI for inputs to construction dipped 0.2% for the month and 0.6% y/y. The PPI for all goods used in construction declined 0.2% and 1.7%, respectively, as the sub-index for energy fell 3.5% and 20%, while the PPI for goods less food and energy edged up 0.1% and 0.7%. The index for services dipped 0.1% in August but moved up 1.1% y/y. PPIs for inputs to seven categories of new nonresidential structures slipped for the month and year, with y/y decreases ranging from 0.3% for educational and vocational structures to 2.9% for power and communications structures. PPIs for inputs to new single-family and multifamily construction rose 0.2% y/y and 0.5% y/y, respectively. **Materials important to construction** that had notable one- or 12-month price changes include diesel fuel, down 5.1% for the month and 21% y/y; asphalt paving mixtures and blocks, up 0.9% for the month but down 6.3% y/y; construction sand, gravel and crushed stone, up 0.2% for the month and 4.5% y/y; and cement, up 0.1% and 5.1%, respectively.*

Hiring plans nationwide for the October-December quarter (4Q16) "improve by 3 percentage points quarter-over-quarter and are unchanged when compared with" 4Q15, after adjusting for seasonal variation, ManpowerGroup reported on Tuesday in releasing its latest quarterly survey of 11,000 U.S. employers. *Employers have a positive outlook for 4Q16 in all 13 industry sectors included in the survey, although "relatively stable hiring plans are reported" for construction (and six other sectors) nationwide and in the Midwest (along with four other sectors). "Slight payroll gains are also anticipated" in the Northeast for construction (and two other sectors); "moderately stronger hiring intentions" for construction in the South; and "a slight decline in staffing levels is expected" for construction in the West.*

Occupancy rates were mixed, while **rents** grew **for** five types of **income-producing properties** in 2Q16, real-estate analysis firm Dividend Capital Research reported on September 1 in its quarterly Cycle Monitor analyzing conditions in more than 50 metro areas. "We recently completed a research study analyzing historic cycle lengths and magnitudes. One conclusion is that the current cycle is a longer cycle than its two predecessor cycles and also a more moderate cycle….We believe that the current moderate U.S. economic cycle expansion should continue for a few years." *A chart shows 10 out of 12 property subtypes were in the expansion phase of the real estate cycle, characterized by new construction along with declining vacancy rates. The exceptions were office—suburban, which was in recovery (no construction despite declining vacancies), and apartments, which moved from expansion to hypersupply (new construction despite increasing vacancy).* "We now believe that the national **office** average **occupancy** [rate] is at the…beginning of the growth phase of the occupancy cycles in this longer and more moderate cycle….*Space under construction was…lower than in 1Q16….*Professional and business services seem to be creating consistent demand for office space….We now believe that the national **industrial** average **occupancy** is…in the growth phase….New supply is not keeping up with demand, especially in the supply-chain tenant segment….We now believe that the national **apartment** average **occupancy** is…in the hypersupply phase of the occupancy cycle….new supply in the pipeline continues to come online at a faster rate than demand…We now believe that the **retail** national average **occupancy** is in the growth phase of the occupancy cycle….*Locations near apartments and new apartment construction are performing the best….*We now believe that the national **hotel** average **occupancy** is at…the peak of the growth phase."