UHERO Construction Forecast Update:

Tremendous Strength as Cycle Peak Approaches

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EXECUTIVE SUMMARY

This forecast update sees continued growth in the seven-year construction cycle. As affordability declines, costs rise, and the macroeconomic environment becomes less supportive, we expect construction activity to approach its cyclical peak over the next several years.

- The housing market continues to be very strong across the state. Growth in resale volume cooled a bit in the first half of 2005, but still remains at historically high levels on all islands. Year-on-year Single family median home price gains range from above 30% on Kaua‘i and the Big Island to 26% on Maui and O‘ahu.\(^1\)

- Commercial and industrial permits fell by 40% last year and have not posted two consecutive years of growth since the late 1980s. However, there are recent signs of life, with commitments to build on O‘ahu surging ahead 63% in the first half of the year.

- Contracting job growth has been running ahead of our March forecast of 6.5% for this year. Statewide, contracting jobs expanded by more than 10% in the first two quarters. Strong growth was seen on all islands.

- After 5.8% growth in 2004, real construction income strengthened to 15.4% in the first quarter of 2005. Statewide construction put in place, measured by the general excise contracting tax base, grew by a robust 14.6% in the same period.

- Based on performance in the year’s first half, construction industry figures for 2005 are now expected to come in somewhat higher than our March forecast. The construction job count will expand by more than 8% by year’s end. Nominal (current dollar) contracting tax receipts, arguably the broadest indicator of construction activity, will surge ahead 12% this year.

- Growth in contracting receipts will slow to just under 5% in 2006. We see marked slowing of job growth to less than 3% growth in 2006.

- Having roughly doubled in the past four or five years, high Hawai‘i home prices are eroding affordability.\(^2\) While long-term interest rates remain at low levels, the Fed continues to raise short-term rates. At the same time, construction costs have risen because of strong global demand, and high oil prices are also affecting construction costs.

- Hurricane reconstruction will put additional upward pressure on building costs. The storms also raise the risks that high energy costs could further slow the U.S. economy or lead to more aggressive Fed tightening to quell inflation.

- As expectation of price appreciation decline and rising interest rates and construction costs mount, Hawai‘i real estate will become a less attractive investment, particularly for offshore investors. Growth in total contracting receipts is expected to slow toward its cyclical peak over the next several years.

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\(^1\) Home price and resale data in this report were provided by Prudential Locations Real Estate Sales & Research.

\(^2\) The Affordable Home price represents the highest priced home affordable to a household earning the median family income, financing that purchase with a conventional 30-year mortgage with 20% down.
State Construction Outlook

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<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
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<tbody>
<tr>
<td>Commitments to Build</td>
<td>2,985,162</td>
<td>4,111,137</td>
<td>3,693,797</td>
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<tr>
<td>% Change</td>
<td>17.51</td>
<td>37.72</td>
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<td>Construction Put in Place</td>
<td>4,536,323</td>
<td>4,921,512</td>
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<td>5,793,950</td>
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<td>% Change</td>
<td>6.11</td>
<td>8.49</td>
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<tr>
<td>Construction Job Count</td>
<td>27.95</td>
<td>29.31</td>
<td>31.75</td>
<td>32.70</td>
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<tr>
<td>% Change</td>
<td>7.57</td>
<td>4.86</td>
<td>8.34</td>
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* Commitments to Build are the sum of private permits and public contracts awarded in thousands of current dollars. Construction Put in Place is the State contracting tax base in thousands of current dollars. The Construction Job Count is in thousands of jobs.

Upcoming UHERO Forecast Reports

4th Quarter: Next Hawai‘i Quarterly Forecast Update.

4th Quarter: The Global Outlook Report. Review of economic conditions in the world economy with particular focus on Asia. Includes forecasts for major countries and regions.


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