

# UM&A MIMM

Spring 2006 Vol. 02

(Memorandum of Industry Momentum and Economics)

*This publication will address economic and industry performance important to Utah and Intermountain businesses, as well as specific industries and sectors of significance to UM&A. We will attempt to include as many national and regional indicators as needed to convey need-to-know information that can assist us in business development and on-going projects. When applicable, we will also wave our own flags of achievement.*

This month we will address the latest economic conditions in the Intermountain region, and look closer at the Construction Industry, which has played a major role in our economic recovery. As usual, the sources of our information include government, industry authorities and academic research centers.

## Overview

Creighton University's Economic Forecasting Group provides our region with a series of business indices mirroring those of the Institute for Supply Management, a national barometer of manufacturing and supply-chain performance. Its surveys are monitored by The Salt Lake Tribune, Denver Post and Wyoming Tribune-Eagle, among other media. This month, Creighton indicated its overall index for February reached a record high, advancing to 75.2 from 71.9 in January. (An index reading over 60.0 is considered optimistic.)

Unseasonably warm weather was the main contributing factor, as businesses responding to Creighton's surveys have both supply-chain relationships and are sensitive to conditions in the construction sector. The warmer-than-expected weather also produced a solid upturn in Creighton's regional employment index, which increased to 72.7 from January's "very healthy" 69.2. Creighton's comments, however, indicated they expect positive-but-weaker hiring over the year's course, as the Federal Reserve Board slows the economy's growth pace.

Other results from Creighton's survey/indices included:

- New Orders: 77.3, up from January's 73.1
- Production: 86.4, up from 80.8
- Inventories: 77.3, up from 73.3

It is notable that February's Delivery Lead Time index stood at a relatively high 54.5, down from 57.7 in January, but an indicator of protracted shipping schedules. (An index over 50.0 portends potential shipping and delivery delays, and has preceded higher prices.) The decline in this index was reflected in the region's Prices-Paid Index, which measures inflation at the wholesale level; it dropped to 90.9, the fourth consecutive monthly decline, and its lowest level since September 2005.

A summary of economic activity in the region, provided by the Federal Reserve Bank's San Francisco District can be found at <http://www.frbsf.org/publications/economics/et/index.pdf>

Utah's unemployment rate, which continues to slide, approached the historic low rates of the roaring 90's in March, when it dipped to 3.4%. This was nearly a full percentage point below last year at this time, and reflected an employment growth rate of 4.3% (48,500 net new jobs). On a national level, the U.S. economy added 2.1 million jobs since March 2005, a growth rate of just 1.6%; the national unemployment rate stood at

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4.7%, according to the U.S. Labor Department. The most vibrant sectors for job growth year-on-year were *professional and business services* (11,400), *construction* (9,100) and *trade/transportation/utilities* (7,900).

In the Construction Industry sector, spending rose to an all-time high in February (latest comprehensive data available at writing time), despite weakening new home sales, according to the U.S. Commerce Department. Overall, construction put-in-place increased 0.8% from January, to [a seasonally-adjusted annual rate of] \$1.19 trillion during the month, which exceeded Wall Street expectations of 0.5%. Private office construction, factories and institutional building displaced the slowdown in residential segments and commercial facilities. This represented \$265 billion, an increase of 0.8% and the fastest pace since October 2001. The government segment slid 0.5% to an annual rate of \$254 billion. These conditions are expected to prevail through the rest of 2006. Details on 2005 and an outlook follow below.

## Construction Industry Sector

We recognize the construction industry has been the most powerful sector driving the engine of economic growth in recent history. In the Intermountain West, a combination of land availability, demographics, liberal public-private development regimes and low interest rates has provided fertile environments for economic expansion, and the delivery vehicle has been construction labor/capital. To put this sector on a national map:

- Construction *specialties* generate a critical mass of jobs, in-and-out of season. Nationally, the industry provides employment to 7.5 million workers —more than 5% of the total [non-farm] workforce. From January 2005-January 2006, total construction industry employment rose by 345,000, or 4.9%; this is triple the 1.6% increase in all new [non-farm] jobs, according to the U.S. Bureau of Labor Statistics (BLS).
- Construction jobs are *better-paying jobs*. In January 2006, [seasonally-adjusted] national hourly earnings in this industry averaged \$19.65 per hour, 20% higher than those of all private industry non-supervisory workers, notes the BLS.
- Construction sub-sectors (Residential and Non-Residential, Government and Private), when combined make a disproportionately *large contribution to Gross Domestic Product (GDP)*. The value of construction put-in-place in 2005 exceeded \$1.1 trillion —nearly 9% of GDP; this is considerably higher than the construction industry's share of total employment.
- A typical construction firm's *size is very small*. According to the U.S. Census Bureau, in 2003 there were 732,000 construction establishments with 6.4 million paid employees, plus 2.1 million firms without paid employees —mainly self-employed individuals, but also partnerships and holding companies. So, average employment was just nine per establishment. (note: the Census Bureau defines an establishment as a permanent business location; most construction firms have only one establishment)
- Small business's share of the construction industry looms very large. In 2003, 91% of construction establishments had fewer than 20 employees; only 1% had 100 or more, and only 435 firms (0.06%) had 500 or more.
- Construction is a *low-margin industry*. The latest IRS [publicly-disclosed] data reveals 649,000 corporations in construction specialties had net income of \$28.4 billion, or 2.6% of total receipts in 2002. The 2003 Construction Industry Financial Survey, conducted by the Construction Financial Management Association revealed net margins in 2002 averaged 1.7%, while return on assets averaged 5.1%.
- Construction is a *high-turnover industry* in context of entry-exit. Census Bureau data shared with the Small Business Administration show nearly 79,000 of the 600,000 firms responding in to Economic Census 2002 (13%) had no employment in 2001, and 81,000 firms closed their doors.

## National & Regional Construction Overview

Observers and analysts in government, industry and trade associations agree that 2005 was another strong year for housing, and a rebound year for non-residential construction. Continuing low interest rates and high demand propelled the residential segment to new records in several regions. The total of all new dwelling units increased nationwide by 6.1% over 2004, and residential housing stock valuation grew 14.3%. Single-family segment construction grew faster than multifamily (as is usually the case); they posted 6.9% and 3.3%

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increases, respectively. All eight States in the [U.S. Census Bureau] Mountain Region achieved gains in total dwelling units (permits) authorized in 2005. More *single-family* housing units were produced in 2005 than 2004 in seven of the eight, excluding Nevada. The results, as revealed by the U.S. Census Bureau:

Montana (69.3%) Idaho (32.9%) Utah (23.9%) New Mexico (15.4%)  
Colorado (6.1%) Wyoming (4.3%) Arizona (2.3%) Nevada (-3.6%)

In Utah, over 28,000 new dwelling units valued at about \$4.7 billion received building permits in 2005; measured by both metrics, it was another record year. Construction activity in this segment was up 16.4%, and valuation rose 31.2%, increasing in every quarter. The robustness of this segment is attributable to rising costs of construction materials and labor and low interest rates, which allow buyers to acquire more home for the money. New single-family housing permits jumped to nearly 21,000 units, up 18% over 2004 to another record; approval levels remained consistent through the year. The Wasatch Front and Iron/Washington Counties dominated *absolute volume* growth, but the Mountainland region—Utah, Summit and Wasatch Counties—led in *percentage growth*, at nearly 27% year-on-year. Davis, Salt Lake, Utah and Washington Counties comprised about three-quarters of *new single-family housing* in the State during 2005. Two years running now, St. George has issued the most single-family building permits in the State (Washington County was the fifth fastest-growing county nationally in 2005, according to the U.S. Census Bureau).

Construction of new *multifamily units* showed a year-on-year increase in just three States in the region: Nevada (71.6%), Arizona (22.5%) and Wyoming (18.0%). This segment's performance declined in Idaho (-1.9%), Utah (-4.5%), New Mexico (-17.3%), Colorado (-22.0%) and Montana (-25.7%). In Utah, condominiums and townhouses represented about 66% of all multifamily activity in 2005, a notable and expanding market for higher-density/owner-occupied housing. Nearly three-quarters of the State's *multifamily* units approved during 2005 were along the Wasatch Front, Mountainlands and Southwest regions. The third major residential construction sector in Utah—mobile homes and cabins—also recorded an increase in 2005 over 2004, 13.3% to just over 800 units. This is considered recovery, following a five-year slowdown.

Following six years of recession conditions in the *nonresidential construction* sector—when up to a quarter of office space was vacant in many major markets—the past two years have seen ramp-ups nationally. Office vacancies in most Metropolitan Statistical Areas fell to a four-year low of 12.5% in the fourth quarter of 2005, from 14.5% in 2004, according to the Cushman & Wakefield consulting group. In Utah, despite a minor decline in the first quarter of 2005, *nonresidential construction* continued its rebound for the third consecutive year. The value of new nonresidential construction approved in 2005 was estimated at \$1.2 billion, up 11.7% from 2004; this was the highest value in five years, last reached when economic growth peaked before the speculative crash of 2000. For the first time since 2000, the *value of permits for office space* passed \$200 million. Similar to previous years, Salt Lake County comprised the preponderance of Utah's nonresidential construction market. An estimated 41% of all commercial, industrial and institutional construction was initiated in the county, reaching nearly \$500 million in value. Major nonresidential construction was underway in Utah County, where \$186 million in new projects were begun, revolving about private sector business centers, the former Geneva Steel site and Lakeside Power Plant. Continuing rapid population and business growth drove this construction segment in Washington County, (nearly \$120 million) and Davis County (\$104 million). Combined, these last three counties accounted for three-quarters of Utah's nonresidential construction in 2005. The total value of State and Public Education construction in Utah exceeded \$555 million in 2005. The State of Utah contracted for nearly \$94 million in building construction, including \$60 million in new construction and \$33 million in additions, alterations and repairs. Major projects included new accommodations at the Central Utah Correctional Facility in Gunnison (\$20 million), the Tooele Courts facility (\$9 million), Salt Lake Community College Jordan Campus Health Sciences Building (\$7 million) and a \$6.6 million multi-agency office building in Ogden.

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## Outlooks

While there are continuing undercurrents of an impending housing bubble nationally, in Utah sources close to the industry expect little slowing. In short, the housing markets appear strong enough to produce new single-family homes at or near record levels in 2006. Owner-occupied units, which comprise an increasing share of new multifamily construction, are also expected to continue their popularity.

Commercial construction is usually one of the last industries to recover from an economic slowdown or stagnation, and the most recent “mini-recession” is no exception. Analysts agree this segment is poised for its best year since 2001, especially in the Intermountain Region. Employment growth in fast-pace markets, along with declining vacancy rates are expected to push investment in nonresidential construction up 9% this year, to \$530 billion nationally, according to the Associated General Contractors of America. Architectural billings, a leading indicator for the construction industry, have risen over the past year, and the American Institute of Architects predicts a 5% real growth rate [after inflation] in 2006. The National Association of Realtors forecasts *industrial vacancies* will fall to 8% this year, spurring a 20% jump in construction; *office vacancy rates* are expected to drop to 11%, pushing up rents by 5%.

The surge in non-residential segments is not limited to the private sector, however. State and local government revenue gains generated issuance of bonds valued at a record approaching \$406 billion in 2005, to refinance debt and finance construction projects including roads, water and sewer works, according to Thomson Financial and *The Bond Buyer*. More than half the amount (\$225 billion) is allocated to new construction projects. In Utah, the State’s budget surplus—which at this writing exceeded \$1.5 billion—had a larger than normal proportion of capital construction element, which has yet to be line-itemed. So, a weaker housing sector seems to have transitioned into a resilient nonresidential performance, both nationally and in the State of Utah.

Some helpful information sources on the construction industry, on which we rely for authoritative guidance and regular updates:

<http://www.agc.org/> (Trade Association for General Construction Contractors)

[http://www.agc.org/galleries/pr/AGC%20Construction%20Inflation%20Alert%20\(FINAL\)%20March%2006.pdf](http://www.agc.org/galleries/pr/AGC%20Construction%20Inflation%20Alert%20(FINAL)%20March%2006.pdf) (An updated guide on Construction Materials Costs for 2006)

<http://www.nahb.org/> (Trade Association for Home Builders)

<http://www.cfma.org/> (Trade Association for Construction Industry Financial Analysts)

<http://www.irs.gov/businesses/small/industries/content/0,,id=99329,00.html>  
(Internal Revenue Service one-stop links for tax and other Construction industry insights)

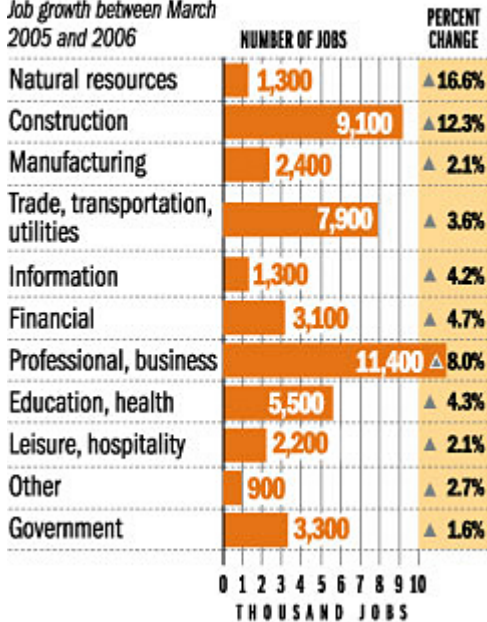
<http://www.irs.gov/pub/irs-mssp/build.pdf>  
(Internal Revenue Service “Construction Industry Guide” for benchmarking, etc.)

<http://www.irs.gov/businesses/article/0,,id=134673,00.html>  
(Internal Revenue Service guide for Cost Segregation in Construction Operations)

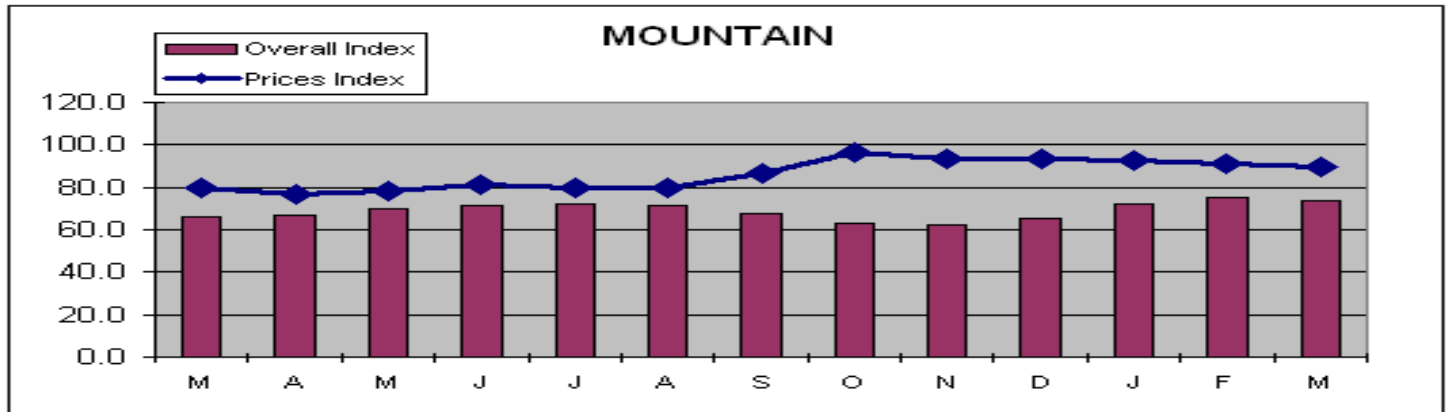
<http://www.fdic.gov/bank/analytical/stateprofile/SanFrancisco/Ut/UT.xml.html>  
(Federal Deposit Insurance Corporation’s Utah report, focusing on Construction)

# Job growth NONFARM, UTAH

Job growth between March 2005 and 2006



SOURCE: Utah Department of Workforce Services



Source: Creighton University/Economic Research Unit

# Cost of living index

MARCH 2006

	WASATCH FRONT			NATIONAL			
	INDEX	% CHANGE (NON-SEAS. ADJ.)		INDEX	% CHANGE (NON-SEAS. ADJ.) (SEAS. ADJ.)		
	MARCH 1988=100	6 MOS.*	1 MO. PRIOR	MARCH 1988=100	6 MOS.*	1 MO. PRIOR	1 MO. PRIOR
All categories	157.1	1.7	0.1	171.6	3.7	0.6	0.4
Housing	177.1	-0.3	0.0	172.7	4.3	0.4	0.2
Transportation	148.1	2.2	0.3	166.1	6.3	0.9	0.9
Health care	157.3	0.1	0.0	244.8	4.1	0.5	0.4
Food at home	189.2	4.0	0.2	168.8	1.9	-0.2	-0.1
Clothing	121.7	5.3	0.2	106.0	-1.5	4.6	1.0
Food away	162.2	0.0	0.0	164.7	3.1	0.2	0.2
Utilities	130.0	5.1	0.0	176.6	19.5	-1.6	-1.1
Recreation	**132.6	0.7	0.0	†109.7	0.9	0.4	0.4
Education & comm.	**119.1	-0.7	0.0	†114.1	2.2	-0.1	0.2
Other goods & svcs.	**104.3	0.0	0.0	238.3	2.9	0.3	0.2

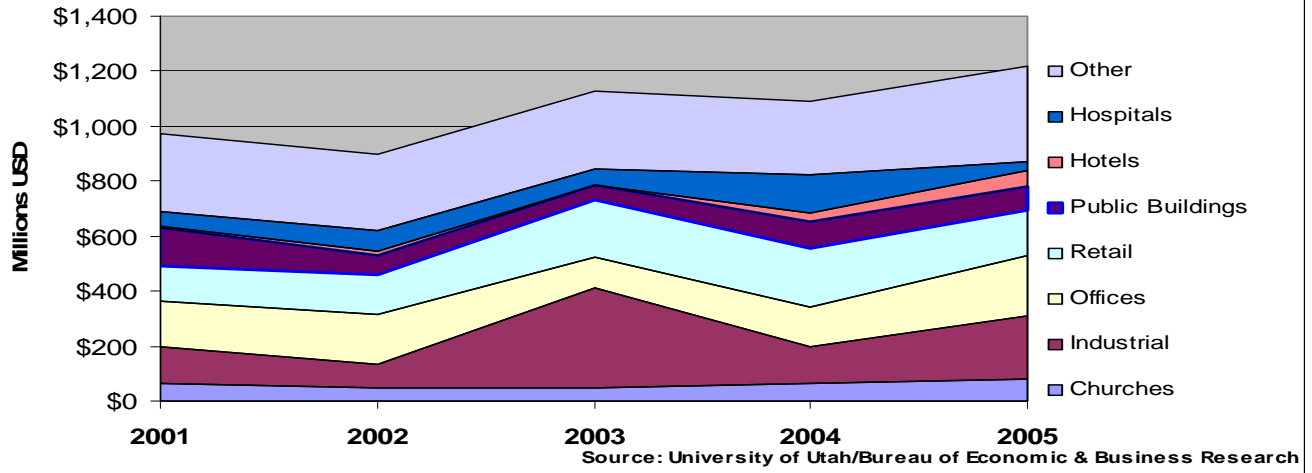
\*Last six-month percentage change compared with same period one year ago.

\*\* (Feb. 1998=100 base)

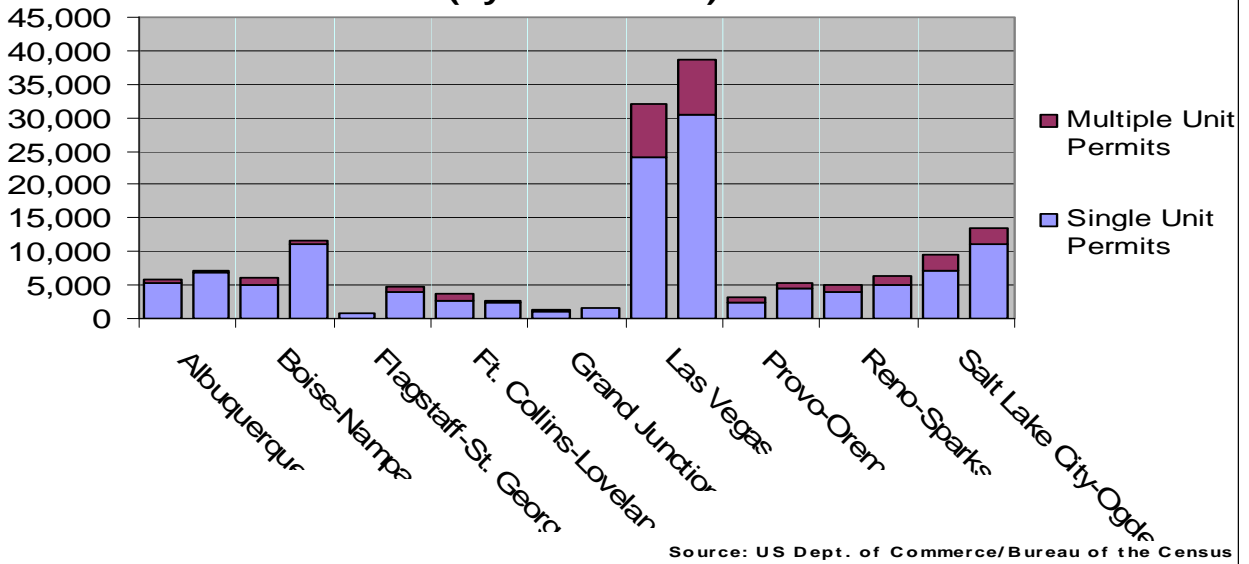
† (Dec. 1997=100 base)

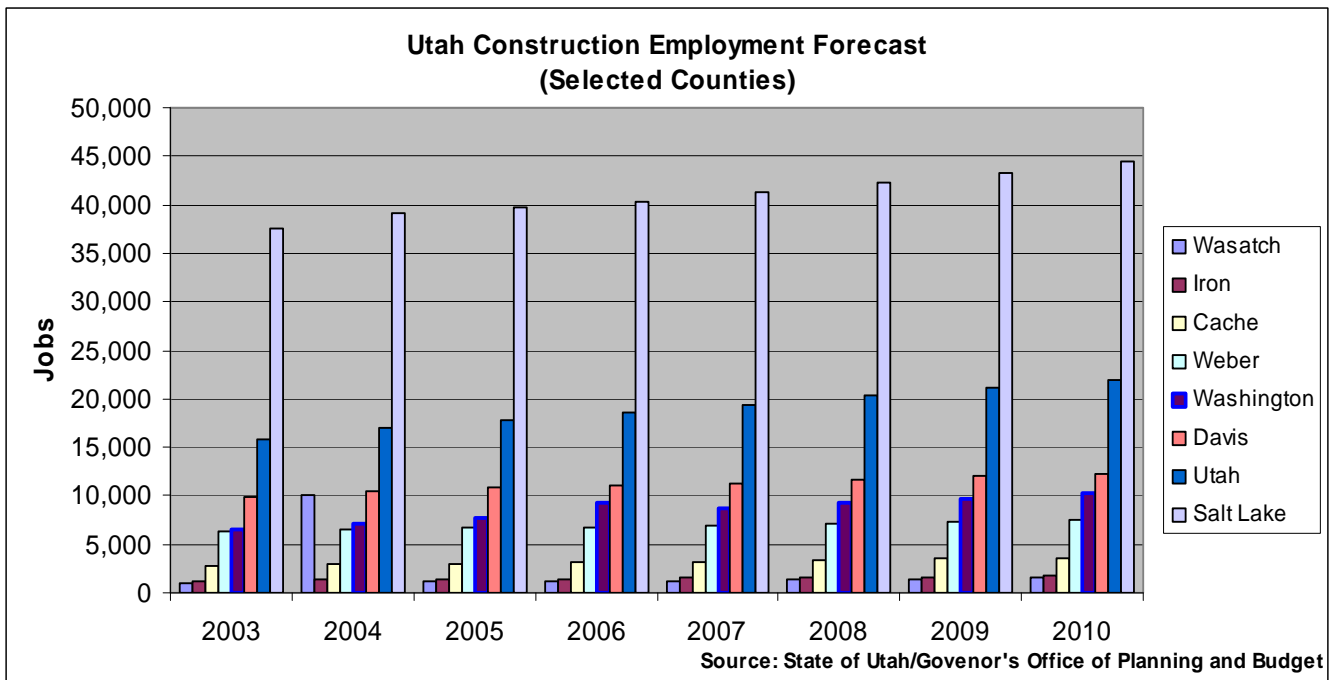
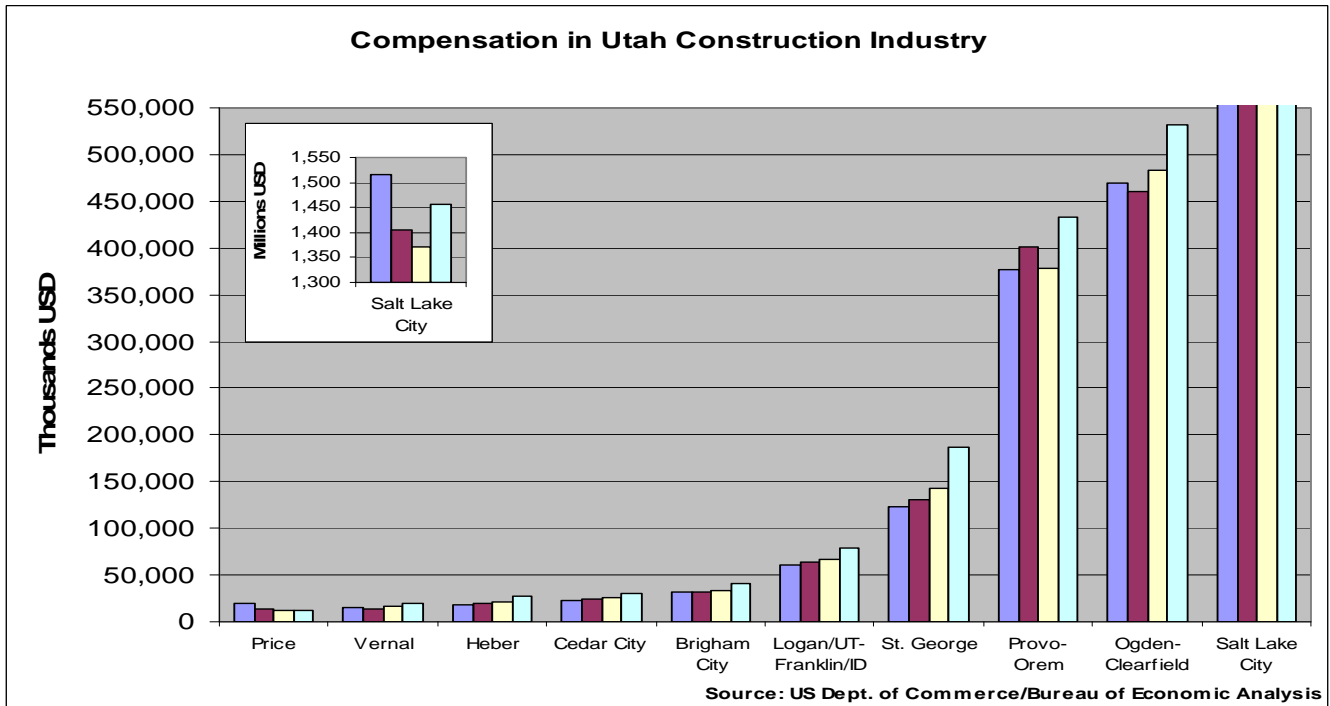
Courtesy of Wells Fargo Bank

### Utah Non-Residential Construction Trends



### Authorized Housing Permits 2001 & 2005 (by Metro Area)





## Percentage Changes in Construction Costs, 2001-2006

	12 months through December--					to March 2006--		
	2001	2002	2003	2004	2005	1 mo.	3 mo.	12 mo.
<u>Overall Consumer, Producer &amp; Construction Prices</u>								
Consumer price index (CPI-U)	1.6	2.4	1.9	3.3	3.4	0.6	1.5	3.4
Producer price index (PPI) for finished goods	-1.6	1.2	4.0	4.2	5.4	0.8	0.1	3.5
New warehouse construction	not available		not available		7.6	0.1	1.7	7.9
Materials and components for construction	0.0	0.8	3.0	10.1	6.1	0.5	2.0	5.9
<u>Costs for Inputs by Construction Types</u>								
Nonresidential buildings	-0.5	0.7	2.4	9.3	7.4	0.9	2.0	6.1
Highway and street construction	-3.6	1.0	2.6	10.8	14.1	2.3	3.4	11.8
Other heavy construction	-2.6	1.0	2.6	13.4	8.8	1.3	2.1	6.8
Multi-unit residential	-0.1	0.4	2.7	8.9	7.6	1.1	2.7	7.0
Single-unit residential	-0.4	0.6	3.5	7.0	6.9	0.6	2.3	6.3
<u>Costs for Specific Construction Inputs</u>								
#2 diesel fuel	-44.7	54.4	13.0	37.9	46.3	5.1	3.9	18.7
Asphalt	not available		10.0	18.3	17.8	14.0	18.0	36.2
Asphalt paving mixtures and blocks	0.9	2.0	3.7	4.3	4.2	3.2	7.3	20.5
Asphalt felts and coatings	4.6	-0.6	6.3	4.1	17.1	-0.4	-0.5	15.4
Prepared asphalt & tar roofing & siding prods	5.0	-1.7	5.3	4.6	18.5	0.5	-1.0	16.7
<u>Concrete products</u>								
Concrete products	2.5	-0.3	1.5	7.6	9.8	1.8	4.8	10.5
Concrete block and brick	2.3	1.6	3.2	4.7	8.1	0.5	4.4	7.9
Concrete pipe	4.4	1.7	1.4	5.5	8.6	-1.1	-0.6	6.3
Ready-mixed concrete	2.5	-1.1	2.1	8.7	11.6	1.5	5.5	11.9
Precast concrete products	0.7	0.3	2.5	6.0	6.4	1.7	2.5	7.2
Prestressed concrete products	5.3	1.8	-0.2	8.2	3.8	11.2	10.5	14.2
Brick and structural clay tile	5.3	1.9	0.7	3.0	9.5	1.4	3.6	8.5
<u>Plastic construction products</u>								
Plastic construction products	-2.7	3.1	3.2	7.2	22.6	-0.1	1.0	20.5
Rubber and plastic plumbing products	-6.3	8.7	5.8	17.8	38.9	not available		
Gypsum products	0.4	3.4	2.8	20.0	18.2	-0.6	6.6	22.9
Insulation materials	0.4	-1.5	2.0	8.6	2.6	-0.1	4.6	6.2
Lumber and plywood	-2.9	1.4	3.1	5.0	-1.0	-0.7	2.7	-3.4
Architectural coatings	2.9	0.6	3.9	5.3	9.2	5.1	5.4	9.9
<u>Steel mill products</u>								
Steel mill products	-6.1	11.1	1.7	48.8	-3.6	0.3	0.2	-3.1
Hot-rolled bars, plates, & structural shapes	-4.3	2.1	11.3	53.8	-0.9	0.4	0.1	-0.2
Steel pipe and tube	-3.7	9.1	3.3	66.0	1.1	0.4	0.9	-1.3
Copper and brass mill shapes	-9.5	-1.6	11.6	29.6	31.0	0.6	7.3	35.0
Aluminum mill shapes	-2.9	-0.9	-0.5	9.9	6.6	0.9	4.7	9.4
<u>Structural, architectural, pre-eng. metal products</u>								
Structural, architectural, pre-eng. metal products	-1.5	-0.4	1.0	26.1	3.1	0.2	0.4	2.5
Fabricated structural metal	-1.3	-2.4	0.1	24.7	3.0	0.5	1.1	4.0
Fabricated structural metal for buildings	-1.5	-3.3	-0.1	20.0	3.3	-0.2	1.2	4.1
Architectural and ornamental metalwork	-0.1	3.7	0.7	23.5	5.9	0.3	-2.5	2.4
Fabricated iron & steel pipe, tube, & fittings	0.6	0.1	1.2	32.6	5.5	0.1	0.8	3.0
Nonferrous pipe, tube, and fittings	0.9	0.8	-0.4	3.6	20.1	0.0	-0.4	16.1
Fabricated steel plate	0.6	-1.0	0.6	7.6	1.0	-0.1	-0.3	0.4
Prefabricated metal buildings	0.0	4.0	-0.7	35.5	2.8	0.0	-0.4	-3.3
Construction machinery and equipment	-0.1	1.9	1.3	6.0	5.0	0.2	2.7	6.2

### Costs for Basic Inputs

Crude petroleum (domestic production)	-42.4	60.6	14.3	30.5	51.3	5.2	2.3	16.1
Industrial natural gas	-36.7	12.2	20.3	20.1	31.5	-8.6	-12.2	19.8
Plastic resins and materials	-9.8	9.2	6.4	28.6	11.5	-1.3	-1.7	5.7
Construction sand/gravel/crushed stone	3.3	2.5	2.4	4.3	7.9	0.9	4.7	9.0
Cement	1.0	1.3	-1.1	7.9	11.7	0.7	7.5	14.9
Iron ore	1.5	-1.3	1.6	6.7	15.5	0.0	11.8	15.6
Iron and steel scrap	-5.6	27.8	64.9	50.8	-10.9	1.9	3.8	10.7
Copper ores	-19.6	3.6	37.4	65.1	34.1	not available		
Copper base scrap	-17.4	11.2	30.7	34.5	52.0	2.6	14.4	57.6

Source: Bureau of Labor Statistics: [www.bls.gov/cpi](http://www.bls.gov/cpi) for CPI, [www.bls.gov/ppi](http://www.bls.gov/ppi) for PPIs.  
Updated March 29, 2006

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