

THE RESIDENTIAL CONSTRUCTION RECESSION AND THE OUTLOOK FOR ADHESIVES IN CONSTRUCTION

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The United States housing market enjoyed an unprecedented expansion from 2000-2005. More than 8.6 million new single family houses were constructed in the United States and the value put in place of all private residential construction over that same time period was \$4.3 trillion according to government census data. Residential construction and expanding rehab and remodeling markets helped push the total market size for adhesives used in construction to more than \$1.6 billion in 2006 (residential and commercial combined). However, recent pressure on the housing market has caused a dramatic downturn in the residential construction industry that could threaten adhesive growth as well.

The current slump in the residential construction market and uncertainty as to how deep the problems will turn out to be is having an impact on adhesive manufacturing industry. In total, the residential and commercial construction markets make up about a fifth of the adhesive industry end uses in the United States. With troubling headlines on subprime lending, housing starts, existing home sales, and falling home prices: Which factors are the most important to consider when forecasting future growth trends for housing and adhesive usage in their construction?

Arguments for a sustained recession in residential construction:

- Subprime defaults will spread to Alt-A (between prime and sub-prime) loans and potential homebuyers may no longer qualify for loans as a lenders scale back credit
- A glut of new housing inventory will continue to put downward pressure on home prices for the next couple of years
- From 2000 to 2005 housing prices rose dramatically and disconnected from wage growth. Prices will need to fall considerably more than they have so far to bring the market back into equilibrium with wages

Arguments for a less severe recession and long term growth in residential construction:

- Ninety percent of homeowners have twenty or more percent equity in their houses. This dampens the downside as potential sellers often stay put during such downturns rather than sell for less then they perceive their house to be worth
- Growth in the number of households will create demand for new homes



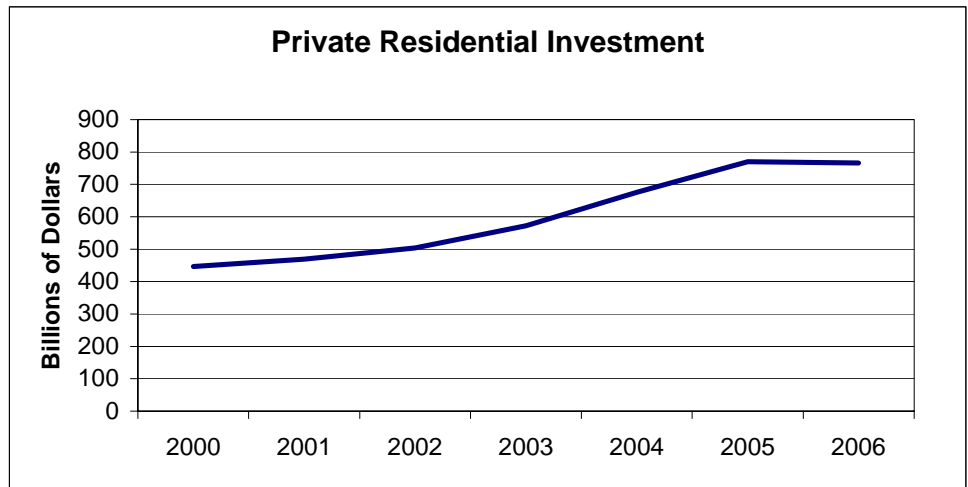
Our view at ChemQuest is that the key long term driver of demand for new housing is the number of households. This indicator is positive and should portend an expansion of the residential construction over the medium to long term. Over the next decade households are expected to grow by 14.2 million according to the Joint Center for Housing Studies of Harvard, based principally on immigrants (documented and undocumented) to the United States. As a consequence new residential housing builds will need to average 1.42 million per year just to keep up with new households.

As far as what will signal that the current residential housing recession is turning around, follow the number of new home sales, not existing home sales. Both of these statistics receive a lot of press coverage, but the new home sales statistic is most relevant to industry participants. New construction is a significant component in the calculation of GDP while the turnover of the existing supply of homes does not have any effect on GDP. During the most recent housing boom new residential investment reached a peak of 6.5% of GDP in the second half of 2005, well above the 4.5% of GDP average of the last thirty five years.

Given the current outlook The ChemQuest Group currently estimates that total adhesive use in the construction sector will grow at an average annual rate of 3.2% from 2006 to 2010 in North America. Primary reasons for the healthy growth in adhesive use in construction include:

- Newly built houses continue to expand in size. The median square footage for single family houses rose from 1535 sq ft. in 1975 to 2,227 sq ft. in 2005
- Increases in the number of bathrooms, garages, and finished basements, and decorative moldings, both interior and exterior in new houses
- The continued use of adhesives for all facets of construction; decks, header boards, staircases, underlayments and various finished carpentry
- Adhesives continue to displace mechanical fasteners and as a way to contain the rising cost of building materials and labor both onsite and through increased use of prefabricated components during construction
- Increased use of prefabricated components during construction also tends to favor the increased use of adhesives because adhesives help maintain the rigidity of the component structure during shipping. This has been demonstrated repeatedly in the manufactured housing segment





Source: U.S. Department of Commerce



About The Author



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Todd joined The ChemQuest Group, Inc. in 1998 after receiving his MBA from Miami University in Oxford, Ohio. As Manager of Strategic Planning, he maintains up-to-date profiles on major industry participants as well as targeted value chains in the Coatings, Adhesives, and Sealants industries. He also holds a B.B.A. degree in Finance and Management from the University of Cincinnati. Contact Todd Muhleman at 513-469-7555.

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