Alaska’s Construction Spending

2010 Forecast

Annual Report for the Construction Industry Progress Fund and the Associated General Contractors of Alaska

By Scott Goldsmith and Mary Killorin
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Dear Alaska Resident,

For the seventh consecutive year, the Construction Industry Progress Fund (CIPF) and the Associated General Contractors of Alaska (AGC) are gratified to provide “Alaska’s Construction Spending Forecast” for your reading and use.

This publication provides an informative review and estimate of construction activity in Alaska for 2010.

Compiled and written by Scott Goldsmith and Mary Killorin of the University of Alaska’s Institute of Social and Economic Research (ISER), the “Forecast” reviews construction activity, projects and spending by both the public and private sectors for 2010.

The construction industry is Alaska’s third largest industry, paying the state’s second highest wages, employing nearly 21,000 workers with a payroll over $1 billion, accounting for 20 percent of Alaska’s economy and currently contributing approximately $7 billion to the state’s economy.

I hope this publication is of value to you. When the construction industry is vigorous, so is the state’s economy.

Roger Hickel
CIPF Chairman

Overview

The total value of construction spending “on the street” in Alaska in 2010 will be $7.0 billion, down 3% from 2009.1,2

Wage and salary employment in the construction industry will continue the slow decline which began in 2006, but the level remains above the long-term average for the industry.

Excluding the oil and gas sector—which accounts for 43% of the total—construction spending will be $4.0 billion—down 4% from 2009.

Private-sector construction spending will be down only 1% from 2009, to $4.4 billion, in spite of the slowdown in the Alaska economy. Oil and gas sector spending will be flat. Spending will increase in the utilities and hospitals3 categories but will decline in mining, residential, other commercial, and the other rural basic sector categories.

Public construction spending will be down 5%, to $2.6 billion, in spite of the infusion of cash from the American Recovery and Reinvestment Act (ARRA). Although some categories of federal spending will be higher, many will be lower and state spending will also be lower because of the lean FY 2010 capital budget.

Uncertainty in this year’s forecast comes from several sources. As we start 2010 there is no clear indication if the national economy is starting to recover from the recession, and if it does, how strong that recovery will be. Although Alaska has been insulated from the worst effects of the recession—the crash in the housing market, high unemployment, and lack of credit—concerns about the national recovery will continue to influence investment decisions in the state, particularly in the commercial and residential markets. Local government capital spending is also vulnerable to reductions in tax revenues from activities, like tourism, driven by the national economy.

The passage of the American Recovery and Reinvestment Act (ARRA) in early 2009 has provided an important boost to construction spending this year. A second stimulus may be undertaken later this year, but it is too soon to speculate on how that might impact construction spending, so we assume no further federal action.

The Alaska economy contracted in 2009 for the first time in 22 years—but the reduction in employment was only about 1%. Forecasts for Alaska’s economy in 2010 vary from further moderate declines in employment to a resumption of growth. This difference of opinion underscores the sense of caution in the business community about the near-term prospects for the economy.

As the year begins, petroleum and precious metal (gold and silver) prices are strong and rising, and base metal prices (zinc) have rebounded from the lows of last year. Petroleum and mining capital budgets are particularly sensitive to these prices, which are likely to continue to fluctuate throughout the year. We assume these prices remain strong throughout the year.

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1 Our revised projection for 2009 was $7.2 billion.
2 We define construction spending broadly to include not only the construction industry as defined by the U.S. Department of Commerce and the Alaska Department of Labor but also other activities. Specifically, our construction spending figure encompasses all the spending associated with construction occupations (including repair and renovation), regardless of the type of business where the spending occurs. For example, we include the capital budget of the oil and gas and mining industries in our figure, except for large, identifiable equipment purchases such as new oil tankers. Furthermore, we account for construction activity in government and other private industries. The value of construction is the most comprehensive measure of construction activity across the entire economy.
3 “On the street” is a measure of the level of activity anticipated during the year. It differs from a measure of new contracts because many projects span more than a single year.
4 A portion of hospital funding comes from public sources.

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Alaska Construction Spending 2010 Forecast

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<thead>
<tr>
<th></th>
<th>Level</th>
<th>Change</th>
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<tbody>
<tr>
<td>TOTAL</td>
<td>$6,999,000,000</td>
<td>−3%</td>
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<tr>
<td>Total without Oil and Gas</td>
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<tr>
<td>Other Rural Basic Industry</td>
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<td>Utilities</td>
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<td>Denali Commission</td>
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<tr>
<td>Other State and Local</td>
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The progress of a number of large projects this year hinges on companies getting the necessary permits and avoiding litigation. An example is the plan by Shell Oil to drill in the Beaufort and Chukchi seas. In these cases our forecast is conservative. We assume delays will postpone some of this spending. If these projects all move forward without delay, actual spending will exceed our forecast.

In spite of the uncertainty associated with the economy this year, there is little downside risk to the forecast. Private construction spending will be dominated by a petroleum industry that invests strategically and is not overly influenced by the current recession. Public construction spending will be driven by money hitting the street from the ARRA.

Public construction spending estimates are perennially complicated by consistent delays in passage of the budget for the federal fiscal year (October through September).

As in past years, some firms are reluctant to reveal their investment plans, because they don’t want to alert competitors, and some have not completed their 2010 planning. Large projects often span two or more years, so estimating cash on the street in any year is always difficult—because the construction “pipeline” never flows in a completely predictable fashion. Tracing the path of federal spending coming to Alaska without double counting is also a challenge.

We are confident in the overall pattern of the forecast—but as always, we can expect some surprises as the year progresses.

**PRIVATELY FINANCED CONSTRUCTION**

The private sector will spend $4.4 billion on construction-related activities in Alaska in 2010. That is 63% of total construction spending, and a decrease of 1% compared with 2009.

**Oil and Gas:** $3.015 Million

Oil and gas industry spending, which will account for 43% of all construction spending in 2010, is expected to be about the same as last year. Spending will be lower on the North Slope, but higher in Cook Inlet and in petroleum manufacturing.

None of the three major producers on the North Slope—British Petroleum (BP), Conoco Phillips, and Exxon—will be exploring, and their spending will be down this year. BP will concentrate on bringing the Liberty field into production, developing existing reserves, and maintaining infrastructure. Conoco Phillips will also concentrate on developing existing reserves, since its Alpine West prospect continues to be delayed. Exxon will concentrate on drilling at Point Thomson.

Three other companies—ENI, Pioneer, and Shell—will have large North Slope budgets this year. ENI will resume

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5 We try to include in this category all spending that is financed primarily from private sources. Although this is relatively straightforward for oil and gas, mining, fishing, timber, manufacturing, and tourism, it is not so easy for hospitals, utilities, and other commercial construction. We include spending from all sources in our hospital and utilities categories. However, in some years most hospital spending is financed by the federal government, and the state provides some of the funding for electric utility investment. Construction activity reported by local governments as residential or commercial often includes projects financed in whole or in part by public sources.
work to bring the Nikaitchuq field into production, and Pioneer will continue the development of the Oooguruk field. Shell has plans to drill offshore in the Beaufort and Chukchi seas, although it has yet to receive a final air discharge permit from the Environmental Protection Agency, and its Beaufort plan faces a legal challenge.

Two small companies—Brooks Range Petroleum and Savant—are planning to drill exploratory wells.

In Cook Inlet, Marathon, Chevron, and Conoco Phillips will all be active, as well as Armstrong Petroleum, which has just signed a contract with Enstar to supply gas. Also, we assume that Escopeta will be successful in bringing a jackup rig to Cook Inlet to drill during the summer.

Plans for a gas storage facility in Cook Inlet, to deal with the challenge of having enough gas to meet demand in Southcentral during the high-demand winter months, are moving forward rapidly. The hope is that storage will be in place by the time the LNG export license expires in 2011, since that facility currently functions to meet the winter peak demand for gas in Cook Inlet. Finally, refinery upgrades are planned at the Tesoro refinery in Nikiski (benzene unit) and will continue at the Petrostar refinery in Valdez (ultra-low-sulfur diesel).

**Mining:**

**$307 Million**

Spending by the mining industry—on exploration, development, and upgrading existing mines—will be down 9% this year. The record high price of gold and the recovery of base metal prices are not enough to offset the completion of a number of large projects last year.

With the exception of Pogo, the other three world-scale metal mines will have significant development budgets this year. The Red Dog mine is working to move operations to the adjacent Aqqualuk site by 2011, although it could be delayed due to a court challenge of its water discharge permit.

Because of the high gold and base metal prices, there are plans to reopen several smaller mines including Rock Creek, Lucky Shot, and Galore Creek.

Donlin Creek and the Pebble prospect have both moved past the exploration phase and are being analyzed for development, so their construction budgets this year are quite modest.

**Other Basic Industries in Rural Alaska:**

**$0 Million**

Investments in facilities to support tourism, the seafood industry, timber processing, and other natural resource industries often occur in rural parts of the state, “hidden” from view. The only major project in this category is the continued development of the dock and cold storage complex at Dutch Harbor, but it is currently on hold with no expenditures expected this year.

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6 Excluding exploration and development costs associated with environmental studies, community outreach and engineering.
Utilities: $482 Million

Spending in this category will be up 23% this year, primarily because of the construction of the new gas-fired electric generation facility by Chugach Electric Association and Anchorage Municipal Light and Power. The Fire Island wind farm project is also moving forward.

The budgets for the major telecommunications firms will be lower this year, and no significant gas utility projects are planned. The first phase of a project to provide high bandwidth Internet service to rural Western Alaska will get underway this year.

There will be numerous smaller electric generation facilities—mostly wind and hydroelectric—constructed throughout the state using funding from the state renewable energy program appropriation.

Hospitals: $221 Million

Hospital spending will be considerably higher than it was last year, with new facilities at the Providence complex in Anchorage again leading the way. Construction of the new hospital at Nome is the other large project that will begin this year. In addition, the first phase of construction of the new hospital in Barrow will also get started.

Other Private Commercial: $153 Million

Private commercial construction spending consists of a wide range of building types, including retail, office, medical, hotel, and warehouse space.7 The level of spending from year to year can be influenced by a few large projects—which is one reason we project spending will be down this year. Several large projects in Anchorage were finished in 2009 and very little is planned for this year.

The absence of large projects reflects both the slowdown in the overall economy and the uncertainty regarding future prospects in general and specifically for the construction of a gas pipeline. Investors in new commercial facilities have adopted a wait-and-see attitude regarding both, and consequently we forecast the level of privately funded commercial activity across the state to be down considerably from last year.

Residential: $208 Million

Although Alaska has been largely insulated from the national housing market crash—both in terms of prices and foreclosures—residential construction will decline again this year, continuing a trend that began in 2007. The decline is the result of the fall in employment and uncertainty about the future growth of the Alaska economy.

7 Our commercial construction figure is not comparable to the published value of commercial building permits reported by Anchorage and other communities. Municipal reports of the value of construction permits may include government-funded construction, which we capture elsewhere in this report. We have also excluded hospitals and utilities from commercial construction to provide more detail about the composition of private spending (even though some hospital and utility spending is funded from public sources).
PUBLICLY FINANCED CONSTRUCTION

Publicly financed construction spending in 2010 is expected to be $2.6 billion, 5% lower than last year, in spite of the stimulus to capital spending provided by the American Recovery and Reinvestment Act of 2009.

Historically, the majority of funding for public construction has come from the federal government, and much of it flows through state government as grants, thus showing up in the state budget. Once in the state budget, these federal funds are often combined with state appropriations.

Federal funds also flow directly to non-profit organizations, like the Alaska Native health organizations, and to a modest extent directly to local governments. Federal agencies, both military and civilian, also have their own capital budgets.

Non-federal funds for state capital spending have historically come primarily from the state General Fund and bond sales. With the growth in complexity of the state budget, an increasing share of state-financed construction is coming out of other funds.

An important source of local government spending is grants from the state. For the larger communities, current revenues and bond proceeds also contribute to construction spending.

Finally, state and local enterprises like the state airports and local wastewater and sewer utilities generate funds for capital expenditures from current revenues and the sale of revenue bonds.

There are numerous ways to categorize public construction spending. We present them by function.

National Defense: $548 Million

Spending for national defense will be up 9% from last year. Military spending is divided into three basic categories—MILCON (Military Construction), civil works, and environmental remediation, including FUDS (Formerly Used Defense Sites). The missile defense system at Fort Greely is budgeted outside these basic categories, and this year the ARRA is an important source of funding augmenting all the basic categories.

The number of active duty military assigned to the state continues to grow and require new facilities, construction of which falls under the MILCON program. The largest share of new construction this year is scheduled to occur at Eielson Air Force Base and Fort Wainwright in Interior Alaska.

The Corps of Engineers provides funds for civil works such as flood control and environmental remediation. We include these corps activities in the national defense total, although they primarily benefit communities rather than the national defense mission.

Transportation—Highways: $610 Million

Spending for highways and roads will be 8% lower than last year, primarily due to the small size of the state capital budget in FY 2010. But a large portion of the proceeds of the recent state transportation bond issue will be available.

A large share of transportation funds comes as a formula grant from the federal government. That program has not yet been reauthorized and is currently operating on a month-to-month basis, with allocations to the states at 70% of the former formula rate. Consequently the state is receiving less than in years past. However, this loss is currently being offset by a significant amount of funding from the ARRA.

Locally funded highway projects will be funded at a level similar to past years.

Transportation—Airports, Ports and Harbors: $323 Million

Spending for airports, ports, and harbors will be lower than in past years because of the absence of funding of projects in the FY 2010 state capital budget and...
the completion of significant upgrades at both the Anchorage and Fairbanks international airports last year. Federal funding in the form of grants from the Federal Aviation Administration will be about the same as in past years. Spending for publicly funded port and harbor upgrades will be about the same as last year, unless the Port of Anchorage receives a large grant under ARRA—in which case the port will be able to move its development schedule forward.

Alaska Railroad: $43 Million

The capital construction program for modernizing and upgrading the Alaska Railroad will continue this year at a slower pace than last year. Project funding comes from a variety of federal sources as well as retained earnings. The focus of the program continues to be track rehabilitation, siding extensions and upgrades, bridge replacement and upgrades, passenger equipment, and a collision-avoidance system. It is possible that work could begin on the Tanana River bridge as part of the rail extension to Fort Greely, if funding can be identified in the Department of Defense budget.

Denali Commission: $61 Million

The Denali Commission, created by former U.S. Senator Ted Stevens to more efficiently direct federal capital spending to rural infrastructure needs, will spend around $61 million for construction—down considerably from last year.

The commission supports a broad range of projects, including transportation, health, and energy-related infrastructure, with funds provided by other federal agencies. The loss in funding has primarily impacted energy and health facilities.

Education: $246 Million

Education project funding will be down 12% from last year. Spending will be up for primary and secondary school construction and upgrades, which are financed by a combination of direct state appropriations for the rural school districts and debt finance for the urban districts. The state continues to reimburse urban districts for most of the interest on school bonds.

University of Alaska construction will be down due to the completion of a number of large buildings. Several buildings are in various stages of planning, but none are ready for construction this year.

Other Federal: $388 Million

The categories already discussed—national defense, transportation, education and the Denali Commission—together make up the largest and most visible part of federal construction spending in Alaska. We forecast an additional $388 million of federally funded capital spending in Alaska for other types of projects—20% higher than last year. Excluding transportation, the largest program funded by federal grants to state government is the Village Safe Water program of rural sanitation. These funds come from a number of agencies, including the Environmental Protection Agency and the Indian Health Service. Funding from these agencies has fallen, but this initiative will again contribute $100 million to state construction spending because of stimulus funds from ARRA.

The federal government also provides grants and other construction funding to Alaska tribes, non-profit organizations, and local governments across the state. The most important recipients of these grants are Alaska Native non-profit corporations, housing authorities, and health-care providers. The largest of

It is difficult to track all the federal dollars that find their way into construction spending in the state because there are so many pathways, and they change every year. The possibility of double counting funds as they pass from agency to agency, or become part of a larger project, also creates difficulties for the analyst.
these programs is the Native American Housing Self Determination Act (NAHS-DA), which provides funds for housing construction in Native communities through many Native housing authorities statewide. These programs will be significantly augmented this year by ARRA funds.

We expect the level of direct construction spending by other federal departments to be about the same as in 2009. This includes spending by the Department of the Interior (National Park Service, U.S. Fish and Wildlife Service, and Bureau of Land Management), the Postal Service, the Department of Agriculture, and the National Oceanic and Atmospheric Administration (NOAA).

Other State and Local: $394 Million

State and local government capital spending, excluding transportation, education, and energy (electric utilities) will be about 10% lower than last year due to the smaller state capital budget of FY 2010 and constraints on local government budgets from the downturn in the economy. The largest state project will be continuation of construction of the new Goose Creek prison in the Mat-Su Borough.

Other important categories of state capital spending are a number of smaller projects funded by the cruise ship tax and small projects funded by the state weatherization and rebate programs. Spending on weatherization could be higher if federal ARRA weatherization funds are leveraged in an AHFC bond package.

Local government capital spending, from general funds as well as enterprise funds, will be about the same as last year, as no significant new projects are anticipated. But tighter finances will be offset by ARRA funds.

WHAT’S DRIVING SPENDING?

Construction activity—measured by total spending, jobs, payroll, or gross product—has experienced strong growth for more than a decade, driven largely by growing federal capital grants to Alaska, large federal agency capital budgets, oil and gas spending, and more recently, large state capital budgets.

These large external sources of construction funds not only fuel public spending and oil patch spending but also give a general boost to the economy—and thus add to the aggregate demand for new residential, commercial, and private infrastructure spending.

CONSTRUCTION IN THE OVERALL ECONOMY

Construction spending is one of the important contributors to overall economic activity in Alaska. Annual wage and salary employment in the construction industry in 2009 was about 16.6 thousand workers, with average annual earnings of $60 thousand per worker. Missing from this total are the “hidden” construction workers employed in other industries like oil and gas, mining, and government (force account workers). In addition, this total does not account for the large number of construction workers who are self-employed—estimated to be about 9,000 in 2009.

Construction spending generates activity in a number of industries that supply inputs to the construction process. These “backward linkages” include, for example, sand and gravel purchases (mining), equipment purchase and leasing (wholesale trade), design and administration (business services), and construction finance and management (finance).

The payrolls and profits from this construction activity support businesses in every community in the state. As this income is spent and circulates through local economies, it generates jobs in businesses as diverse as restaurants, dentists’ offices, and furniture stores.

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