EXECUTIVE SUMMARY

OVERALL ECONOMY  Looking ahead to 2014, the view doesn’t seem too bad. The overall forecast calls for continued modest growth. Although most economic indexes are positive, they are just barely so. And, while not necessarily negative, we are seeing a repeating pattern of “two steps forward, one step back.” During the recession, more than 2 million construction jobs were lost — and they’re not coming back. Slow, steady growth gives the industry time to rebuild without being exposed to spiraling labor and material costs.

Data (which we will highlight in this report) indicates that the only sector experiencing double-digit growth is residential construction, although we expect most areas to grow slightly ahead of GDP growth. There are some concerns, however, especially in markets dependent on infrastructure growth. Commercial construction is still waiting on consumers who are working their way out of debt or trying to find good-paying jobs. The job market is improving, but still uncertain in most parts of the country.

In large part, improvement in the U.S. economy is being hampered by perceptions that the government is unable and unwilling to get anything done. Bickering continues over the Affordable Care Act, for example, with a constant barrage of scenarios explaining how it will finally impact us. A budget deal has been passed, but there are a number of uncertain variables still in existence, from long-term unemployment support to a raise in taxes to increased revenues. Discussions on a tax overhaul are imminent for 2014 in Washington, D.C. One exception might just increase the effect of government spending on construction, which shrank about 5% in 2013, with more “sequestration-type” cuts possible in 2014. With recent discussions of sequestration cuts being divided between 2014 and 2015, it’s important to monitor them and identify changes that may decrease the amount of government construction put in place.

Things are gradually picking up for the economy. Indicators are a bit more positive, and consumer confidence is on the uptick (although you will see that, in the Consumer Confidence Index graph on page 5, the steady incline from the start of 2013 through July has come to a halt). This change in confidence is largely responsible for the decrease in construction put in place, and 2014 projections from our 2013 Summer Edition of the Electronic Systems Outlook. This is likely for the best because it will give the economy time to sustain growth, and slow down the rate of change in interest rates, wages, and the costs of goods (see Consumer Price Index graph, page 5).

As noted above, one of the positive areas this year has been a continued growth in residential construction, which has historically preceded improvement in the commercial sector. For example, new housing developments lead to demand for more schools, hospitals, and retail establishments. Panelists in FMI’s 3rd Quarter Nonresidential Construction Index (NRCI) noted that the lag time between residential and commercial construction was likely to be 18 to 24 months. To this point, it is largely an emotional link. If residential construction continues to grow, it will help the feeling that the economy is getting back on track, and that owners in the commercial construction sector should consider investing. Additionally, with a federal budget that appears to be on a stable track for the immediate future, there could be more confidence in the construction industry as well.

In this edition of our Electronic Systems Outlook, you can compare the outlook of electronic systems put in place from the 2013 Summer Edition and the 2012 annual totals to start seeing trends. Keeping up on these ever-changing trends is important; for example, our growth projections based upon the first half of 2013 have now been reduced due to shifts in key economic factors, resulting in preparation for modest growth in 2014.
EXECUTIVE SUMMARY

CONSTRUCTION OUTLOOK Our overall forecast for U.S. commercial construction put in place has been revised to reflect a slight downturn for the short term. Total commercial construction put in place for 2013 will finish at $352.5 billion, which is down 0.5% from 2012. We expect modest growth of 4.7% in 2014, reaching $368.1 billion, followed by stronger growth in 2015 and 2016. Construction will once again outpace GDP growth, and should continue to do so for the forecast period.

There are a few economic concerns that touch all market sectors. The first is the continued decline in public (government) construction and expectations of more as the sequestration continues. Second, lenders are still tight with their lending criteria. Consumers are still cautious about increasing their debt load, and that includes their share of public debt with new bond issues for local municipalities.

Interest rates, while still low by historical standards, are creeping up for consumers. Most seem to have absorbed the new tax structures into their budgets, but are uncertain as to the cost of healthcare. The boom areas of shale oil exploration are helping tremendously in some regions, but haven’t flowed over to the rest of the nation. If, as many have suggested, U.S. energy prices continue to stay low and exports increase in the coming years, this will help fuel the economy in several ways. . . but that will take more time. Still, the outlook is better than it has been for several years.

COMMERCIAL ELECTRONIC SYSTEMS CONSTRUCTION PUT IN PLACE

<table>
<thead>
<tr>
<th>Quad 2013</th>
<th>Total Nonresidential Building Construction Volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>$352.5 Billion</td>
</tr>
<tr>
<td>Commercial Electronic Systems Construction</td>
<td></td>
</tr>
<tr>
<td>Share of Total Construction</td>
<td>5.5%</td>
</tr>
</tbody>
</table>

Visit the Summary section of this report on page 18 that provides outlines for all of the markets and electronic systems as a whole, in addition to showing Canadian construction trends. In upcoming reports, we plan to break out more information on the electronic systems in the Canadian market — so keep a watchful eye.

EXECUTIVE SUMMARY

KEY ECONOMIC INDICATORS It is important to consider key economic indicators such as CPI, CCI, and unemployment rates when evaluating this report, because they provide the general pulse of the economy; these three factors determine interest rates and funding of construction projects.

The Fed (formerly known as the Federal Reserve Bank/Federal Reserve) controls interest rates, which CPI, CCI, and unemployment all affect. The graphs below highlight historical changes in CPI, CCI, and unemployment rates.

CPI is a measure of the average change over time in the price paid by urban households for a set of consumer goods and services. An increase in CPI usually leads to adjustments in interest rates in order to control costs of goods and adjust for inflation. Additionally, CPI is often used in calculating wages, pensions, and salaries.

The CPI graph shows the national percent of change of costs for consumer goods and services over the course of the last 30 years.

CCI is calculated based on a survey of 5,000 U.S. households; it is interpreted by the Conference Board, which extracts data from the survey to forecast future spending by consumers. In general, a 5% swing in either direction is needed to influence a change in decision-making.

The Conference Board Consumer Confidence Index graph shows the economic downturn in 2008, and reflects an improving CCI. Despite some uncertainty, an upward trend in CCI in early 2013 also reflects a positive trend in investing in commercial construction. The cessation of upward trending CCI around June of 2013 is a key contributing factor to many of the variances in overall construction from the Electronic Systems Outlook: Summer Edition 2013.
Unemployment continues to decrease on the national level, showing more confidence in spending and an improvement in the general economy (although this is occurring at a slightly decreasing rate). Often, a decrease in unemployment directly correlates with the increasing trends in the construction industry.

**EXECUTIVE SUMMARY**

**RESIDENTIAL** Growth in residential construction continues to show some traction. However, we expect the rapid growth to taper off to 12% in 2014. Increasing interest rates will keep large housing bubbles from forming. The total forecast for residential, including improvements, is $379.6 billion, compared with $338.2 billion for 2013. Total residential was $619.8 billion in 2006 before the bubble burst. Now we are in catch-up mode for all of those people who have been putting off buying a home.

We expect housing starts to be a jagged line over the year, partly seasonal and partly economics, as the government and other large businesses continue to downsize. However, the shadow inventory of homes in foreclosure is diminishing, and that is helping to bring housing prices up. At the same time, housing inventory has increased to 21.4% during 2013. This push/pull supply and demand will keep the rise of residential housing in check until wages catch up with price gains, which is happening for the high-wage earners, but not for the middle-class homebuyers.

**Trends:**
- According to CoreLogic, completed foreclosures were down 25%. The total number of homes in foreclosure fell to 940,000, compared to 1.4 million a year ago.
- Home prices continue to increase. Nationally, home prices rose 12.1% over the last 12 months.

**Drivers:**
- Unemployment rate slightly improved
- Core CPI decreased slightly
- Income increasing
- Mortgage rates increasing
- Home prices increasing
- Housing starts increasing
- Housing permits increasing

While the residential sector does not directly create demand for most NSCA members, we should recognize the impact that housing has on other construction segments. Commercial, healthcare and educational segments in particular tend to follow changes in the housing sector. Likewise, home equity values have direct impact on consumer confidence and discretionary spending that drive markets such as retail and hospitality.
EXECUTIVE SUMMARY

VERTICAL MARKET OUTLOOK Each of the market segments detailed in this report (corporate, education, government, healthcare, houses of worship, lodging, manufacturing, retail, and other buildings) feature a 2013 outlook to show growth potential and the evaluation of electronic systems for that market, as well as trends and drivers. Remember, this information is based upon actual data from Q1 2013 through November, and forecasted for the remainder of the year.

Consultants and integrators will find this data helpful in the very early stages of design, and should consider using the “percentage of total vertical market construction” averages as a starting point in discussions with clients, tracking how their local marketplace compares to national averages. Furthermore, this information is critical when budgeting for a project. It can be used to measure growth opportunities and monitor market share potential. These averages can be used when working with clients to show comparative solutions that fit within the average dollars spent on systems in each vertical market. It gives a baseline average for a good-better-best solution, and helps guide clients by avoiding underfunding, which leads to a sub-par system installation.

The graphs throughout this report specifically outline the systems involved in the low-voltage industry:

- **Acoustics, Audio, and A/V**: includes but not limited to building lighting control, emergency lighting, accent lighting, digital signage
- **Life Safety: Fire & Security**: includes but not limited to fire, smoke and security alarm systems, flood safety, air quality sensors, building access systems, nurse call stations
- **Lighting, Digital Signage**: includes but not limited to building lighting control, emergency lighting, accent lighting, digital signage

DATA COLLECTION This bi-annual report includes forecasting and systems modeling. FMI first generates a forecast for building construction put in place (new construction, repair, and renovation). Econometric modeling is used to estimate demand. Each market segment has an independent algorithm based on five to eight metrics that have historically correlated best to changes in activity for that market segment over the past 50 years. A preliminary forecast is then adjusted based on database records for current/planned projects, funding and timing of those projects, contractor backlogs, and FMI’s direct interaction with engineers, architects, owners, and contractors in the field.

Next, the forecast for total construction put in place is modeled to its components and systems. This report is based on analysis of proprietary project records (what goes into construction of a K-12 school of a certain size and geography, for example), and through discussion with architects and estimators. Emerging trends (code changes) are explored through supporting secondary research; final adjustments to the model outputs are then made.

CROSS-SECTORS The Systems Outlook below provides trends on the volume of electronic systems put in place since 2012:

SYSTEMS OUTLOOK / CORPORATE in Millions of Current Dollars

<table>
<thead>
<tr>
<th>Year</th>
<th>Acoustics, Audio &amp; A/V</th>
<th>Phone Systems, Data Networking, Tel</th>
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<tbody>
<tr>
<td>2012 Total</td>
<td>274.8</td>
<td>595.9</td>
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<td>8.1%</td>
<td>87.9%</td>
<td>82.3%</td>
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Trends:
- According to the National Association of Realtors, “vacancy rates in the office sector are expected to decline from a projected 15.7 percent in the third quarter to 15.5 percent in the third quarter of 2014.”
- Asking rents are increasing in major metros like New York City and Chicago, but are flat around most of the country. The trend toward new construction will focus on areas of high job growth in technical fields.

Drivers:
- Office vacancy rate decreasing
- Unemployment rate slightly improved

Use these tools when budgeting, to see growth opportunities, and monitor market share potential.

The Systems Outlook below provides trends on the volume of electronic systems put in place since 2012:

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EDUCATION

Education construction dropped 4% for 2013, due to budget cuts for government spending at all levels. Schools will pick up slightly in 2014 to gain 4% over 2013 levels at an annual rate for construction put in place of $84.7 billion. The increases in residential construction and tax revenues for states and municipalities will help bring this market back in many areas of the country. At the same time, states and communities with decreasing populations, due to people moving to find better jobs, continue to try to consolidate older, underutilized schools. Private schools may continue to suffer as parents facing tight budgets avoid the higher costs. For higher education, students are becoming more discerning about their return on investment and taking a closer look at the growing number of degree programs offered online.

GOVERNMENT

The forecast for government construction continues to be slow, dropping 2.6% in 2013 and expecting to regain just 0.7% in 2014. Sequestration has had a dramatic impact, though demand remains strong – particularly for office improvements and prisons. The Bureau of Prisons reports that it has a backlog of 154 modernization and repair projects with an approximate cost of $349 million. Potential spending of more than $60 billion in border security could change things.

SYSTEMS OUTLOOK / GOVERNMENT

Trends:

• Over the past 30 years, according to a new report by the Congressional Research Service (CRS), the federal prison population has jumped from 25,000 to 219,000 inmates, an increase of nearly 790 percent.
• The Pentagon is seeking a $150 million overhaul of the U.S. detention facility at Guantanamo Bay.
• Government appointed its first chief greening officer (under GSA) to oversee aggressive pursuit of sustainable practices in government buildings.
• Public private partnerships (P3s) overcome shortfalls in public financing.

Drivers:

• Population increasing
• Government spending decreasing
• Incarceration rate increasing

Use these tools when budgeting, to see growth opportunities, and monitor market share potential.

The Systems Outlook below provides trends on the volume of electronic systems put in place since 2012:

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<tr>
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<td>186.4</td>
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2012 Total – total electronic systems construction put in place in 2012
2013 Summer Outlook – outlook of total 2013 electronic systems construction put in place based on actual data for the first 2 quarters of 2013 and forecasted for the remainder of 2013
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% of total construction – shows the percentage of dollars spent on electronic systems in relation to the total dollars spent on construction in the given vertical market

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% of total construction – shows the percentage of dollars spent on electronic systems in relation to the total dollars spent on construction in the given vertical market.
HEALTHCARE

Healthcare construction slipped 0.5% in 2013, but is still expected to grow 6% in 2014 to $44.0 billion. Demographics continue to drive the forecast, and baby boomers are retiring in larger numbers and more likely to need greater healthcare. However, there is a larger elephant in the room that makes prediction a bit dicey right now. The Affordable Healthcare Act, is set to provide access to affordable health insurance for millions of Americans who are currently uninsured. This looks like a potentially sudden shock to the system, even though it has been coming for three years now. There is also the concern for the continually rising healthcare costs. Meanwhile, healthcare providers will continue to focus on reducing costs for new facilities through use of technology.

HOUSE OF WORSHIP

Religious construction has been a shrinking market for more than a decade. Our forecast calls for another lean year in 2014 growing just 3% after dropping 5% in 2013. What growth we see will likely be renovation, as newly formed congregations move into vacated retail space or reoccupy church buildings abandoned by other faiths. As the housing market slowly continues a growth trend in the coming years, we may also see more expendible income for contributing to new community houses of worship.

Trends:

• Many churches are seeing tremendous declines in contributions and tithes.
• More parishioners are relying on their houses of worship to provide guidance and assistance, further stretching thin resources.
• Improved space utilization and additions are taking the forefront, as new construction is increasingly not an option.
• Churches are becoming smarter about attracting parishioners who are drawn in by facilities and the church building itself.

Drivers:

• GDP increasing
• Population increasing
• Income increasing

Use these tools when budgeting, to see growth opportunities, and monitor market share potential.
MANUFACTURING

Manufacturing construction dropped by 2% in 2013 following a strong 2012. However, a 4% growth is forecast in 2014 due to manufacturing firms looking to return to the U.S. A reduction in energy costs in the U.S. relative to other countries around the globe, in addition to the increase in transportation costs, manufacturing will continue to reconsider operations in or returning to the U.S. Furthermore, several other factors are providing a boost to manufacturing such as the resurgence of the automobile industry and continuing exploration and mining for shale oil and gas. This resurgence in manufacturing will be slow, but any improvement will be felt throughout the economy.

MANUFACTURING VERTICAL MARKET OUTLOOKS

Drivers:
- Industrial production increased slightly
- Capacity utilization increased slightly
- Factory orders increasing
- Durable goods orders decreasing
- Manufacturing inventories increasing

Use these tools when budgeting, to see growth opportunities, and monitor market share potential.

The Systems Outlook below provides trends on the volume of electronic systems put in place since 2012:

Trends:
- Capacity utilization slipped 0.1% to 77.6 percent, 2.6 percentage points below its long run (1972-2012) average.
- "Reshoring of manufacturing" is happening slowly, and is likely to accelerate due to availability of lower energy costs.
- The U.S. has surpassed Saudi Arabia in oil production and is now the #2 producer behind Russia.
- Tremendous investments are being made to build, expand and upgrade petrochemical facilities.

lodging

Lodging construction came back to life in 2012. However, the pace of growth has slowed since last year; we have decreased our growth forecast from 15% for 2013 to 9% for 2014 to reach a total of $14.3 billion. One of the key measures of the hospitality market is revenue per available room (RevPar), which is up 5.0% in 2013. Interest rates remain low for those looking to improve existing properties or build new, but lenders are still conservative. That means the high-end properties and major business destinations like New York City will have the best chance of expansion.
RETAIL
Construction increased just 2% in 2013, growing to 5% in 2014. Retail sales were up 5.7% over the previous year, but that wasn’t enough to start a significant upturn in new construction. New bricks and mortar retail space will continue to be slow to recover, as many companies turn to Internet mail-order sales. Pay close attention to the growth in digital signage among the retail market as retailers try new ways to increase sales (over $30 million increase from 2012 to 2013).

OTHER BUILDINGS
Electronic systems installed in Other Buildings are roughly $25 million ahead of our projected outlook this summer, and there is not one technology that appears to be driving this nearly 0.5% increase in total volume. These markets (listed below) account for almost 3.7 billion dollars of electronic systems sales mostly stemming from life safety, lighting, and digital signage. We plan to continue to break more of the markets out of “Other Buildings” outlook to provide a more detailed breakdown in future editions of this report.

Other Buildings includes:
- Amusement and recreation: Venues such as movie theaters, stadiums, arenas, performing and visual arts, convention centers, etc.
- Transportation: Facilities associated with air, land, and sea travel; primarily passenger terminals
- Communication: Buildings related to television & radio (broadcast and production), etc.

TRENDS:
- Expect more rethinking of commercial construction space to accommodate smaller stores and to combine in-store sales with online shopping.
- Increased store remodeling could stall new construction.
- Look for increasing multisite projects.

DRIVERS:
- Retail sales increasing
- CPI decreased
- Unemployment rate slightly improved
- Income increasing

Use these tools when budgeting, to see growth opportunities, and monitor market share potential.

The Systems Outlook below provides trends on the volume of electronic systems put in place since 2012.

OTHER BUILDINGS

<table>
<thead>
<tr>
<th>Vertical Market</th>
<th>2012 Total</th>
<th>2013 Summer Outlook</th>
<th>2013 Winter Outlook</th>
<th>% of Total Construction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acoustics, Audio &amp; A/V</td>
<td>262.3</td>
<td>866.9</td>
<td>1,891.3</td>
<td>1.9%</td>
</tr>
<tr>
<td>Video Systems, Data Networks, IT</td>
<td>202.5</td>
<td>607.1</td>
<td>1,131.7</td>
<td>1.1%</td>
</tr>
<tr>
<td>Building Automation &amp; Control</td>
<td>233.6</td>
<td>625.0</td>
<td>1,460.2</td>
<td>1.5%</td>
</tr>
<tr>
<td>Lighting</td>
<td>235.0</td>
<td>617.3</td>
<td>1,400.2</td>
<td>1.4%</td>
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<tr>
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NOTE: “Other Buildings” includes Amusements & Recreation, Transportation and Communication.

NOTE: These numbers are construction-related project based. Only projects with building permits were factored into these numbers. For some systems integrators this represents the vast majority of their revenues, and for others, only a portion.

NOTE: Non-building structures are generally horizontal construction projects (roadways, bridges, tunnels, etc.).

CONSTRUCTION OUTLOOK SUMMARIES

CANADA CONSTRUCTION OUTLOOK

FMI does work extensively in Canada with a team dedicated to that area. The historic rule of thumb for Canada was that it was 10% of the U.S. — no matter what you were talking about. Over the past 8 years that has changed dramatically, such that today total Canadian construction volume is closer to one-third of the U.S. The recession in Canada was not nearly as deep or broad, and the residential sector held up relatively well. The government invested heavily in real infrastructure projects, especially in Ontario. And the oil & gas industry created a boom in Western Canada. We are expecting moderation in the rate of Canada’s growth, but the economy will show steady gains for the next 10 years. It is estimated that the Canadian volume is about 18% of the U.S. systems contracting based on the non-residential building sector. However, owners and drivers are different in Canada that needs to be taken under consideration. NSCA will be reviewing this information in the reports to come.

CONSTRUCTION OUTLOOK / CANADA - in Millions of Current Dollars

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