



**Gilbane**

SUMMER 2014

# **BUILDING** for the **FUTURE**

**CONSTRUCTION  
ECONOMICS**  
Market Conditions  
in Construction

# SUMMARY

## CONSTRUCTION GROWTH LOOKING UP:

Construction spending for 2014 will finish the year 5.5% higher than 2013. All sectors will contribute to the growth. See Table 2.

*We started the year at an annual rate of spending near \$940 billion and should finish at a rate of \$990 billion.*

- A correlation between the Architectural Billings Index (ABI), Dodge Momentum Index (DMI) and new starts cash flows has twice predicted the direction of nonresidential spending over the last two years. Current forward look shows a flat period in Q4 2014 then a rapid rise in 2015. See Figure B, Figure 3 and Figure 4.

ENR published selling prices for 2013 and 2014 that show contractors adding to their margins.

Construction jobs are up 11% from the low point. Jobs plus hours worked show that total labor effort is up 18%. Forty percent of the total increased labor effort in the last three years is due to added hours.

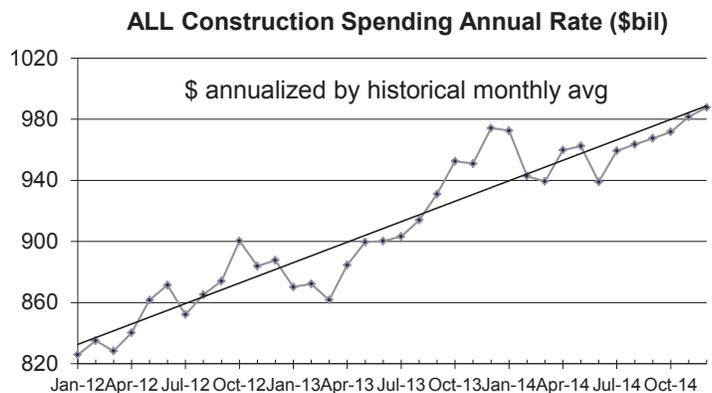


### ➔ FIGURE A:

#### All Construction Spending Rate of Growth 2012-2014

Total spending of ALL types of construction will grow just under 7% year over year from 2013 to 2014. We started the year at an annual rate of spending near \$940 billion and should finish at a rate of \$990 billion. We may experience a Q1-Q2 2014 slowdown, but expect continued growth after May. Residential and nonresidential buildings lead the expansion while nonbuilding infrastructure holds back growth.

Total spending of ALL types of construction will grow 5.5% year over year from 2013 to 2014. We started the year at an annual rate of spending near \$940 billion and should finish at a rate of \$990 billion. We did experience a Q1-Q2 2014 slowdown, but expect continued growth after June. As expected, nonresidential buildings contributed to the dips in March and June, but will help lead the expansion for the second half.



## **SOME ECONOMIC FACTORS ARE STILL NEGATIVE:**

- We experienced a slight slowdown in construction spending that bottomed in March and June, influenced by dips in all sectors. We predicted this drop in our last report. The monthly rate of spending for nonbuilding infrastructure may hold back total spending for the year. Refer to Figure 6.
- Real inflation adjusted constant construction volume is still 22% below peak and has not yet returned to the level of volume in 1993. At the historical rate of volume growth, it will take seven to eight more years to regain previous peak volume levels.
- The construction workforce is still about 1.5 million below the previous peak level. At peak average growth rates, it will take a minimum of five more years to return to previous peak levels.
- As workload expands in the next few years, a shortage of available skilled workers may have a detrimental effect on cost, productivity and the ability to readily increase construction volume.
- In two recent surveys, CFOs expressed concern over the financial condition of subcontractors. The slow recovery impact on subcontractors may yet show some have not been able to withstand the long downturn.

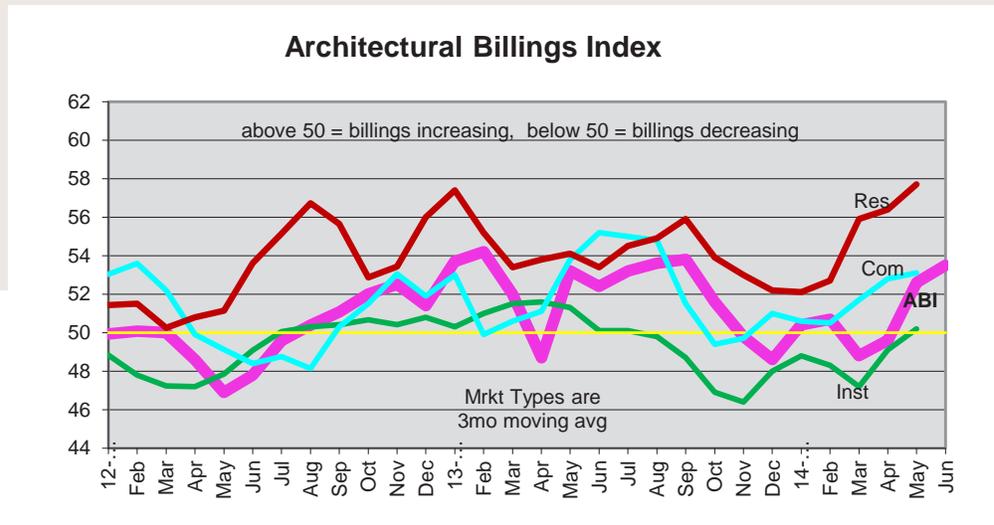
## **THE EFFECTS OF GROWTH:**

- As spending continues to increase, contractors gain more ability to pass along costs and increase margins. Selling price indices for 2013 and 2014 show contractors as built price both years is above labor and material cost inflation. Margins are increasing.
- Since the low point of spending in January 2011, spending has increased 15%. Construction labor effort has increased by 18%. This sounds good, but spending corrected for inflation shows construction volume has increased by only 5%. Productivity is declining.
- Growth in nonresidential buildings and residential construction in 2014 will lead to more significant labor demand. This may lead to labor shortages and productivity losses. Margins regained a positive footing in 2012 and extended those gains in 2013. Expect margins to grow stronger in 2014. When activity picks up in all sectors, escalation will begin to advance rapidly.



**FIGURE B:**

**Architectural Billings Index 2012-2014**

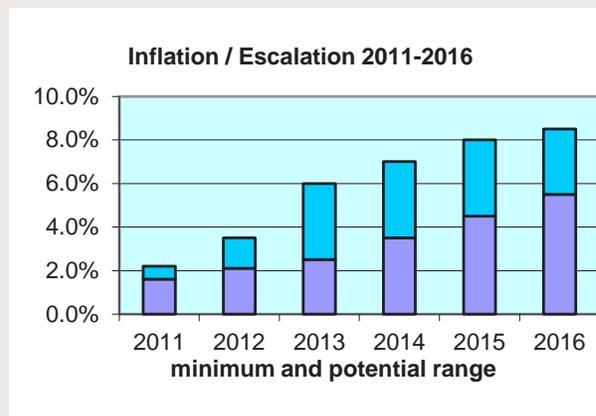


**IMPACT OF RECENT EVENTS:**

There are several reasons why spending is not rapidly increasing: public sector construction remains depressed; public educational spending is the single largest contributor to the drop in public spending; lenders are just beginning to loosen lending criteria for project financing but are not providing equal terms to lend working capital to subcontractors; consumers are still cautious about increasing debt load, including the consumers' share of public debt, and we may be constrained by a skilled labor shortage.

**FIGURE C:**

**Inflation / Escalation 2011-2016**



Future escalation, in order to capture increasing margins, will be higher than normal labor and material cost growth. Lagging regions will take longer to experience high escalation. Residential escalation is currently near, or even above, the upper end of the range.

- We advise a range of
- 3.5% to 7% for 2014
  - 4.5% to 8% for 2015
  - 5.5% to 8.5% for 2016

*The most favorable forward-looking conditions I've seen in years support my expectations for strong growth and profits in 2015. Very active markets will drive escalation to climb more rapidly than we have seen in six years.*

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*The information in this report is not specific to any one region. The information is limited to the United States and does not address international economic conditions.*

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## DATA SOURCES:

Along with countless news articles, these sources are used for data in this report:

- American Institute of Architects – [www.aia.org/practicing/economics/index.htm](http://www.aia.org/practicing/economics/index.htm)
- American Iron and Steel Institute - [steel.org](http://steel.org)
- American Recycler - [americanrecycler.com](http://americanrecycler.com)
- Associated Builders and Contractors - [abc.org](http://abc.org)
- Associated General Contractors of America - [agc.org](http://agc.org)
- Bloomberg L.P. Financial News - [Bloomberg.com](http://Bloomberg.com)
- Bureau of Labor Statistics - [Stats.BLS.gov](http://Stats.BLS.gov)
- Construction Industry Round Table – [www.cirt.org](http://www.cirt.org)
- Data Digest – [agc.org/datadigest](http://agc.org/datadigest)
- Economic Cycle Research Institute - [businesscycle.com](http://businesscycle.com)
- Engineering News Record - [ENR.com](http://ENR.com)
- Financial Trend Forecaster - [Fintrend.com](http://Fintrend.com)
- FMI Management Consulting - [FMINET.com](http://FMINET.com)
- IHS Global Insight - [ihs.com](http://ihs.com)
- Institute for Supply Management - [ism.ws](http://ism.ws)
- McGraw Hill – Dodge – [construction.com/about-us/press](http://construction.com/about-us/press)
- Metal Prices – [metalprices.com](http://metalprices.com)
- Producer Price Indexes - [bls.gov/ppi/](http://bls.gov/ppi/)
- Reed Construction Data - [reedconstructiondata.com](http://reedconstructiondata.com)
- RS Means - [rsmeans.reedconstructiondata.com](http://rsmeans.reedconstructiondata.com)
- U.S. Census Bureau - [census.gov](http://census.gov)

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The image shows a modern office interior with a large window overlooking a city skyline. In the foreground, there are two red armchairs and a low coffee table with a vase of yellow flowers. The ceiling has recessed lighting. A white rectangular sign with the word "Gilbane" in a bold, sans-serif font is superimposed over the center of the image. The "G" is white, and the rest of the letters are dark blue.

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