

Gilbane



CONSTRUCTION ECONOMICS
MARKET CONDITIONS IN CONSTRUCTION

2014 SPRING



SUMMARY

CONSTRUCTION GROWTH LOOKING UP

- ▶ Construction Spending for 2014 will finish the year 6.6% higher than 2013. Nonresidential Buildings will contribute substantially to the growth. See Table 2.
- ▶ The Architecture Billings Index (ABI) in 2013 dropped below 50 in April, November and December briefly, indicating declining workload. Overall the ABI portrays a good leading indicator for future new construction work. See Figure B.
- ▶ ENR published selling price data for 2013 that shows contractors adding to their margins.
- ▶ Construction jobs grew by 156,000 in 2013, less than anticipated. However, hours worked also grew by 3%, the equivalent of another 150,000+ jobs.

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.



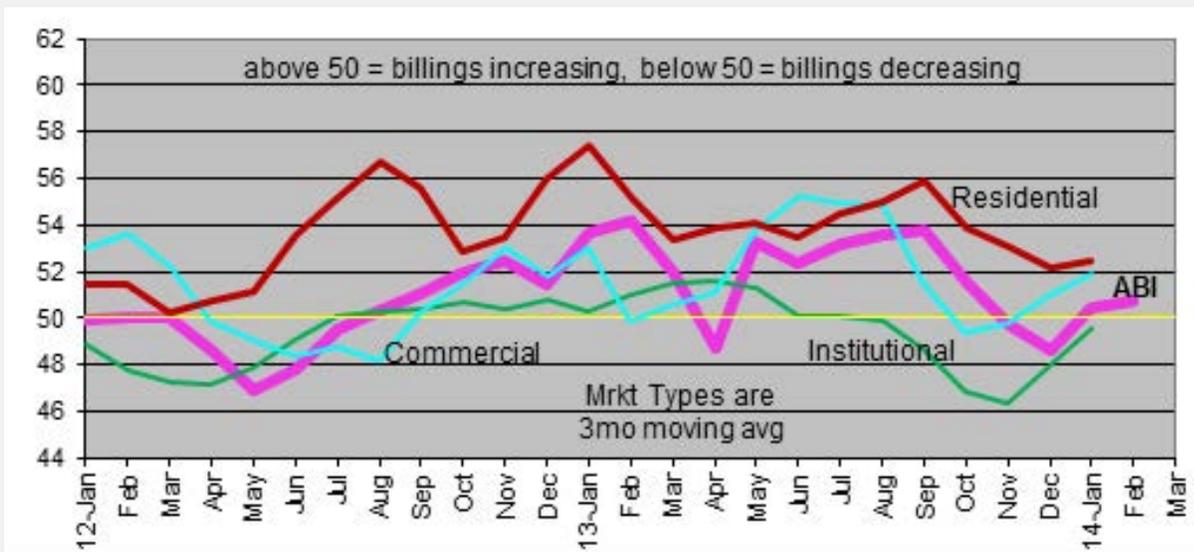
SOME ECONOMIC FACTORS ARE STILL NEGATIVE

- ▶ We are experiencing a slight slowdown in construction spending that could last through May, influenced by a slight dip in nonresidential buildings and a brief flattening in residential, but more so by a steep decline in nonbuilding infrastructure spending. The monthly rate of spending for nonbuilding infrastructure may decline by 10% through Q3 2014. Refer to Figure 7.
- ▶ The construction workforce and hours worked is still 22% below the 2006 peak. At peak average growth rates, it will take a minimum of five more years to return to previous peak levels.
- ▶ Construction volume is 23% below peak inflation adjusted spending, which was almost constant from 2000 through 2006. At average peak growth rates of 8% per year, and factoring out inflation to get real volume growth, it will take eight more years to regain previous peak volume 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.

THE EFFECTS OF GROWTH

- ▶ Construction spending during the first five months of 2013 declined from the rate of spending in Q4 2012. Growth has been inconsistent, even in the booming residential sector, which has seen recent declines. We see more consistent growth in 2014 for buildings.

FIGURE B: ARCHITECTURAL BILLINGS INDEX 2012-2013



- ▶ As spending continues to increase, contractors gain more ability to pass along costs and increase margins. The growth in contractor margins slowed since last year. However, expected increases in volume should reverse that in 2014.
- ▶ ENR's Third Quarter 2013 Cost Report shows general purpose and material cost indices increased on average about 2% to 2.5% year over year. However, selling price indices increased 4% on average. The difference between these indices is increased margins.

IMPACT OF RECENT EVENTS

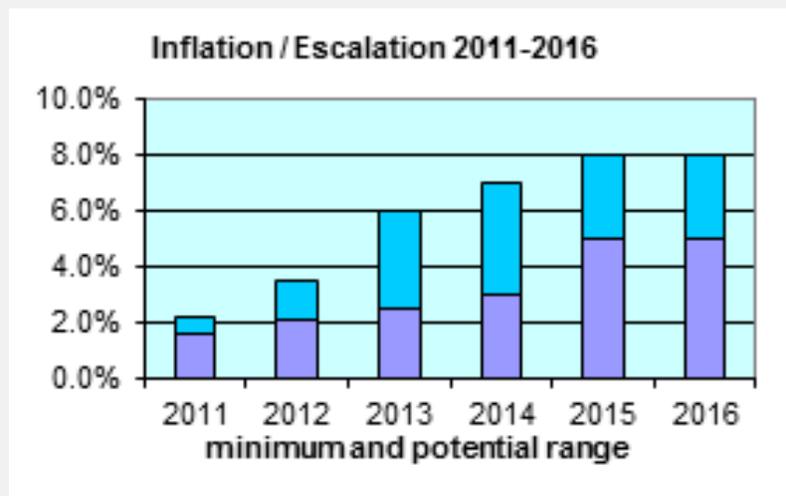
- ▶ There are several reasons why spending is not rapidly increasing: public sector construction remains depressed as sequestration continues; the government is spending less on schools and infrastructure; lenders are just beginning to loosen lending criteria; consumers are still cautious about increasing 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 near, or even above, the upper end of the range.

We advise a range of:

- ▶ 3% to 7% for 2014
- ▶ 4% to 8% for 2015
- ▶ 5% to 8% for 2016



Supported by overall positive growth trends for year 2014, I expect margins and overall escalation to climb more rapidly than we have seen in six years.

Growth in nonresidential buildings and residential construction in 2014 will lead to more significant labor demand, resulting in 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.

ABOUT THIS REPORT

Gilbane Inc. is a full service construction and real estate development company, composed of Gilbane Building Company and Gilbane Development Company. The company (www.gilbaneco.com) is one of the nation's largest construction and program managers providing a full slate of facilities related services for clients in education, healthcare, life sciences, mission critical, corporate, sports and recreation, criminal justice, public and aviation markets. Gilbane has more than 50 offices worldwide, with its corporate office located in Providence, Rhode Island. The information in this report is not specific to any one region.

Author Ed Zarenski, a 40-year construction veteran and a member of the Gilbane team for 35 years, is an estimating executive who has managed multi-million dollar project budgeting, owner capital plan cost control, value engineering and life cycle cost analysis. He compiles economic information and provides data analysis and opinion for this quarterly report.

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DATA SOURCES

- ▶ American Institute of Architects – www.aia.org/practicing/economics/index.htm
- ▶ American Iron and Steel Institute - steel.org
- ▶ American Recycler - americanrecycler.com
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- ▶ Reed Construction Data - reedconstructiondata.com
- ▶ RS Means - rsmeans.reedconstructiondata.com
- ▶ U.S. Census Bureau - census.gov

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