When Does This Get Better?

By Preston Ingalls

According to a survey conducted of 1,300 construction firms by the Associated General Contractors of America (AGC), the industry is not likely to experience a strong recovery until at least 2012. A clear majority of firms expect the dollar volume of projects they compete for to either grow or remain stable in the Highway, Other Transportation, Water/Sewer, Power, Manufacturing, Hospital/Higher Education, Public Building, and K-12 construction markets. With construction spending down 20 percent in 2010 from 2008, most contractors expect their markets to remain fragile.

According to AGC, half (49%) of the highway contractors expect highway funding to decline in 2011. This is a reflection of the growing fears about the end of the stimulus, a projected 10-percent decline in state transportation budgets and diminished Congressional willingness to fund new federal infrastructure investments. With the major post-election emphasis in Congress on cutting spending, this shortfall looks to be well founded. Contractors' low expectations might be driven by the fact that most firms expect stimulus-funded construction activity will decline this year. Clear majorities of firms (ranging from 56% to 66%) expect stimulus spending in every market segment to decline in 2011. Meanwhile, only 30 percent of firms report they plan to perform stimulus-funded work this year, down from the 45 percent that reported performing stimulus-funded work in 2009 or 2010.

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Despite the belt tightening, AGC's survey showed that more firms (27%) plan to add staff this year. But the fact that more firms plan to hire than lay-off, even in an environment of relatively weak demand, probably signifies that contractors suspect the worst is over and are taking cautious steps to prepare for a turnaround in the market.

AGC's survey showed that in contrast with the employment picture, demand for construction equipment appears sluggish. In 2010, 34 percent of firms purchased construction equipment and 51 percent of firms leased or rented equipment. In 2011, 28 percent of firms plan to purchase new equipment, and 50 percent of firms plan to rent or lease. Firms are expanding their equipment fleets to be a bit more aggressive than last year.

Despite growing pessimism within the Highway and Other Transportation construction contractor sector, more than a third of these firms plan to purchase more new construction equipment than any other construction segment.

According to Fail Management Institute's (FMI) *The 2011 U.S. Markets Construction Overview*, highway and street construction is expected to hold on to slight gains as the remaining stimulus funds are used and the highway bill is extended rather than reauthorized. Highway and street construction is facing a tough climate as state revenues decline. The funding from ARRA was enough to offset these losses in 2010 and may help into 2011. However, reauthorization of SAFETEA-LU will again come under debate. State funds will be the big question for 2011.

According to FMI, 2010 was a major disappointment for the construction materials sector (construction aggregates, cement, ready-mix concrete, and hot-mix asphalt). Most material producers were hoping for a recovery in 2010 and a return to normalcy. Those expectations are on hold until 2011 or beyond. The consensus is more of the same with modest gains expected next year. The

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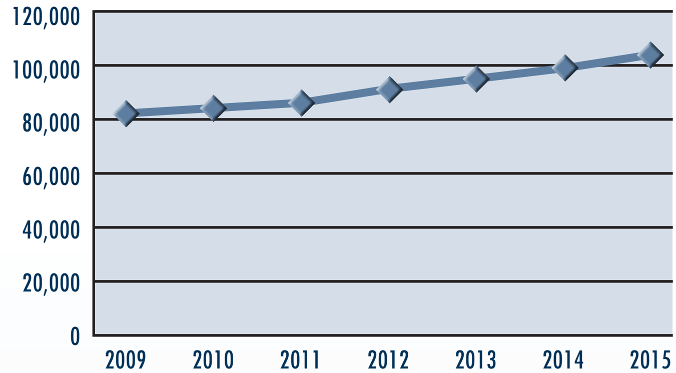
optimism increases beyond 2011 into 2012 and 2013, especially once there is a new highway bill and improved outlook for job growth.

WHAT DOES THE FUTURE BRING?

AGC projects the outlook for the construction industry is certainly brighter in 2011 than it has been for the past 2 years, but the industry is still facing significant headwinds. On the positive side, construction employment may pick up a bit, markets are stabilizing—especially in key private sector areas—and contractors are feeling empowered to begin addressing their profit margins. Overall, weak demand, stagnant equipment orders, rising health care costs, and the fading benefits of the stimulus are all working against the industry.

Longer term, projections look rosier as the population increases, funding become more available, and weaker competitors begin to wash out or are acquired. FMI projects road spending as shown in the chart on the right.

Value of Highway & Street Construction
In Millions of $



Source: Falls Management Institute's (FMI) *The 2011 U.S. Markets Construction Overview*

According to U.S. Department of the Interior's projections from the *U.S. Geological Survey, Mineral Commodity Summaries 2011: U.S. Geological Survey*, "With U.S. economic activity remaining sluggish, construction sand and gravel output for 2010 stayed near the low levels experienced in 2009. The flat demand for construction sand and gravel reflected the struggling U.S. construction industry, with unemployment in many areas over 20 percent for construction workers. It is estimated that 2011 domestic production will begin to improve as the small but important increases seen in the second half of 2010 continue in 2011. A rapid recovery to recent highs is unlikely, however, as tax revenues that fund government construction projects continue to be depressed by lower home values. Additionally, demand for new housing is suppressed by the inability of unemployed and underemployed consumers to afford new homes. Movement of sand and gravel operations away from densely populated centers was expected to continue where environmental, land development, and local zoning regulations discouraged them. Consequently, shortages of construction sand and gravel would support higher-than-average price increases in industrialized and urban areas."

Despite the sluggish results, when all those factors are considered together, it means the industry is in for a year that is off to a soft start but will slowly and progressively improve in the later part of 2011 and early 2012. ■