THE 2011 CONSTRUCTION HIRING AND BUSINESS OUTLOOK

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The Associated General Contractors of America * 2300 Wilson Blvd., Suite 400, Arlington, VA 22201 * (703) 548-3118

Summary

Despite predictions of slight growth in demand for several key construction sectors and an improving construction employment picture, construction firms are bracing for at least one more difficult year as the benefits of the stimulus begin to fade and overall demand for construction remains weak. Indeed, according to an analysis of survey responses from nearly 1,300 construction firms conducted by the Associated General Contractors of America and Navigant, the industry is not likely to experience a strong recovery until at least 2012.

Market Outlook is Difficult, But Improving

With the Power and Health Care/Higher Education sectors leading the way, construction demand should begin to stabilize in 2011. 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. The only two market areas where a majority of contractors expect declines are Retail/Warehouse/Lodging and Private Office construction.

Stability does not mean growth, however. Even in the category where contractors are most optimistic, Hospital/Higher education, only one in three contractors predicts an increase in demand. In most of the other categories, the number of contractors predicting declines in demand outweighs the number of contractors predicting growth by at least two to one. Instead, a good number of contractors expect markets levels to remain at the same level as in 2010. With construction spending down 20 percent in 2010 from just two years earlier, most contractors expect their markets to remain weak, instead of getting even weaker.

It is important to note that the outlook for the Manufacturing and the Retail/Warehouse/Lodging sectors is significantly more positive for 2011 than it was last year. Sixty-four percent of contractors expected Manufacturing construction to decline and 71 percent of contractors expected the Retail/Warehouse/Lodging sector to decline in 2010. Yet now 58 percent of contractors expect the Manufacturing sector to either grow or remain stable while 48 percent of contractors expect Retail/Warehouse/Lodging construction to either grow or remain stable.

By contrast, only 38 percent of contractors expected Highway funding to decline in 2010, while 49 percent expect it to decline in 2011, reflecting 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.

Growing Number of Firms Plan to Hire

More firms (27%) plan to add staff this year than plan to lay off staff (20%), in contrast to 2010 when a majority (55%) of firms reported laying off employees and only 20 percent reported adding staff. Further, firms planning to add staff expect to hire an average of 23 employees, while firms that plan to lay off expect to cut an average of 16 employees this year. That is in marked contrast to 2010 when the average layoffs amount (an average of 30 per firms) exceeded the average hiring amount (an average of 17 employees per firm).

There is still quite a bit of uncertainty regarding the labor market (53% report they don't know or don't plan to change their staff size) for construction this year. But the fact that more firms plan to hire than fire even in an environment of relatively weak demand may indicate that contractors suspect the worst is over and are taking tentative steps to prepare for a turnaround.

Regardless of construction market type, contractors' answers were remarkably consistent when it came to their staffing plans. Firms working in Power and Manufacturing construction had the most positive responses, with 28 percent saying they plan to add staff in 2011. Meanwhile more firms working in Highway and Other Transportation construction (24%) plan to lay off staff in 2011, likely reflecting the reality of declining stimulus, state and local funding and stagnant federal funding.

Demand for Construction Equipment is Stagnant

In contrast with the employment picture, demand for construction equipment appears, at best, stagnant. In 2010, 34 percent of firms purchased construction equipment and 51 percent of firms leased or rented equipment. But only 28 percent of firms plan to purchase new equipment this year and only 50 percent of firms plan to rent or lease.

Firms that are expanding their equipment fleets plan to be more a bit more aggressive than last year, however. Firms planning to purchase equipment say they will invest an average of nearly $880,000 while the firms planning to lease or rent plan to invest an average of $719,000. In comparison, last year firms adding equipment invested only $672,000 and those that rented or leased spent $674,000.

Despite growing pessimism within the Highway and Other Transportation construction community, more firms (36%) working in this market segment plan to purchase new construction equipment than from any other construction segment. Interestingly, more firms working in Manufacturing construction (61%) than from any other segment plan to lease or rent new construction equipment – perhaps reflecting temporary optimism in that sector.

The Stimulus is Fading, But Helped Many Firms

Nearly half (45%) of respondents' firms were awarded at least one stimulus-funded contract to date. That's a surprisingly high fraction, given that the stimulus accounted for less than one-tenth of nonresidential construction spending in 2009 and 2010. Stimulus-funded work amounted to an average of $13.6 million in revenue per each firm doing the work.

Within firms performing stimulus work, an average of one out of every five employees was engaged in stimulus-funded activities. If not for the stimulus, it is hard to believe firms would have had enough work to keep many of those employees on the payroll. But even as the stimulus helped many firms and many construction workers, it didn't lead to significant increase in new construction equipment purchases, as only five percent of firms reported adding new equipment because of the stimulus. Given the overall decline in construction activity, it is likely firms were able to use existing and otherwise idle equipment on their stimulus projects.

More troubling is the fact that only 30 percent of respondents expect to perform stimulus funded work in 2011. Indeed, majorities of contractors expect declines in stimulus-funded activity in Highway, Building, Utility, Private Construction, Water Resources and Other Public Works construction.

Perhaps not surprisingly, Highway, Other Transportation and Water/Sewer firms were the most likely to have worked on stimulus-funded projects (59%, 58% and 57% respectively), while firms working in retail construction were least likely (41%). For 2011, firms working in Other Transportation – primarily transit and airport construction – as well as Highway and Water/Sewer firms (38%, 37% and 37% respectively) expect to perform more stimulus-funded work than any other type of construction firms. And again, retail construction firms have the least expectation of working on stimulus-funded projects (27%).

Despite "Reform," Health Care Costs are Rising

Adding pressure on construction firms' bottom lines, 71 percent of firms report they expect their health care costs to increase. Respondents specifically cited changes to the nation's health care laws that were enacted last year as the reason the cost of covering employees is increasing. Many firms indicate that increasing health care costs are forcing them to reconsider plans to add staff. Some firms even indicated they are considering either scaling back, or altogether eliminating, health care coverage for their employees as a result of the increasing cost of coverage.

Bid Levels are Stabilizing, But Recovery Isn't Here Yet

Intense competition and declining demand for construction forced most contractors to lower their margins in 2010. Based on the responses, 81 percent of contractors adjusted their bid amounts last year to earn a smaller profit. Of these, seven percent reported that they actually reduced their bids to the point where they performed work at a loss.

While lower bid amounts are good news for construction consumers, they made it difficult for construction firms to upgrade equipment, expand payrolls, or even weather current market conditions. Fortunately for the industry, bid prices appear likely to stabilize in 2011, with 68 percent of contractors reporting they plan to either keep their bid margins at current levels or to actually increase their profit margins. One in three firms plan to lower bid levels, including only three percent of firms that plan to bid below their costs.

Assuming contractors are able to keep bid levels stable, or to increase their bid levels, the construction industry is likely to see greater stability within the construction industry this year. That will allow firms to protect remaining cash reserves and to begin positioning themselves to expand capital investments in the mid-term.

Despite intentions to the contrary, however, contractors are likely to face pressure to again cut into their profit margins. That is because most contractors feel market conditions will remain very difficult throughout 2011. Only 16 percent of contractors expect the construction market to grow in 2011. Fortunately, 48 percent of respondents expect demand to improve in 2012, while 35 percent of contractors don't expect a recovery until at least 2013.

Use of Building Information Modeling Will Increase

Firms reported using Building Information Modeling (BIM) technology in only eight percent of their projects in 2010. BIM technology typically uses three-dimensional, real-time, dynamic building modeling software to increase productivity in building design and construction. Despite this seemingly low number, it is interesting to note that firms are still making the investment in BIM even in a difficult economy. Indeed, 55 percent of respondents report they expect use of BIM to increase in 2011, while only 11 percent expect BIM use to decrease. This likely reflects a growing appreciation among construction firms of the cost savings and increased productivity that come with BIM technology, as well as the need to compete with others who already offer BIM.

Firms working in the Hospital/Higher Education market report the highest use of BIM technology (10 percent), followed by firms working in Public Building (10 percent), Manufacturing (9 percent) and Power construction (9 percent). This is probably being driven by the complexity of the projects and growing demand from public-sector owners for firms to use BIM. Firms working in "horizontal" construction – the Water/Sewer (7 percent), Other Transportation (5 percent) and Highway (5 percent) categories – report the lowest use of BIM technology compared to firms working in other market segments.

The Number of LEED Registered Projects Will Grow

Despite the overall weak demand for construction, contractors expect the number of green projects will increase in 2011. Already, respondents reported that an average of 15 percent of projects they completed were Leadership in Energy and Environmental Design (LEED) registered. Meanwhile, 53 percent of firms expect demand for LEED registered projects to increase in 2011 and only 20 percent expect demand to drop. This growing trend represents a significant opportunity, especially for building contractors, to tap into the growing appetite for green projects to help them weather what is likely to be another difficult year for construction.

Firms involved in the Hospital/Higher Education market report working on the highest number of LEED registered projects (18 percent), followed by firms working in the Public Buildings market (18 percent) and K-12 market. This is a pretty clear indication that public and institutional owners are increasingly demanding green construction projects. If these trends continue, it is difficult to see how the rest of the market won't follow. Perhaps reflecting the different nature of horizontal construction, where there are few structures to register as "green," firms working in the Water/Sewer (12 percent), Other Transportation (10 percent) and Highway (9 percent) markets report the least amount of involvement with LEED registered projects.

Slow Growth for Integrated Project Delivery

In contrast to the growing use of BIM and expanding demand for green construction, contractors appear hesitant to embrace Integrated Project Delivery (IPD). Using IPD, project delivery becomes a collaborative process among a team of participants all focused on a common goal who share equally in project profits and losses. This is contrasted with the usual design-bid-build process where each participant focuses exclusively on their part of the project without considering the impacts on their work on the project as a whole. IPD projects often utilize lean construction principles and BIM technology.

In 2010, contractors reported they performed an average of 0.26 IPD projects. Despite significant room for growth in the use of IPD, it appears few contractors expect to work on those kinds of projects in 2011. Only 29 percent of contractors expect to work on an increased number of IPD projects, while an overwhelming majority of contractors actually expect to work on fewer IPD projects in 2011.

Given that IPDs are most often associated with complex construction projects, it makes sense that firms working in the Manufacturing (0.41 projects), Hospital/Higher Education (0.38 projects) and Power (0.35) markets report working on the highest average number of IPD projects. Meanwhile firms working in the horizontal markets – Water/Sewer (0.28 projects), Other Transportation (0.23 projects), and Highway markets (0.21 projects) – report being involved in the least amount of IPD projects.

Bright Future for Public Private Partnerships

There appears to be broad consensus that the number of public private partnership (PPP) projects will increase in 2011. Public Private Partnerships, which have been used to deliver projects all over the world, are slowly catching on in the United States. In a PPP, a public entity works in partnership with the private entity, usually a consortium of companies, where the private entity finances, designs, builds and operates the facility in exchange for the revenue associated with that facility. PPPs have been used in the United States to construct toll roads, bridges and military housing, for example.

With 70 percent of construction firms reporting they expect an increase over the average of 5.2 PPP projects they worked on this year, it seems clear that PPPs will be increasingly popular. While any number of reasons could be driving this perception, the most obvious is that the public sector will need to rely increasingly on PPPs as their budgets remain constrained for the foreseeable future.

Despite their association with a number of high profile highway project in the U.S, firms working in the Highway sector report being involved with the lowest number of PPP projects, an average of only 0.85 projects per firm. By contrast, firms working in the Private Office, Retail/Warehouse/Lodging and Hospital/Higher Education markets report being involved with the highest number of PPPs, an average of 5.9 per firm. No doubt political opposition to "selling" roads and difficult financial markets have stifled some of the mid-decade interest in highway privatization projects. Perhaps these figures reflect the fact that the public sector is getting increasingly involved in helping finance or support more traditional private sector shopping and commercial real estate projects as a way to jump start local economic activity.

Many Firms Have Embraced Lean Construction

Based on the survey results, it appears that lean construction – which is a way of organizing the construction process to minimize waste of materials, time, and effort – has taken root within the construction industry. Nearly half of the responding construction firms (46%) report that they have implemented lean construction concepts into their business model. It is likely that many firms have embraced lean construction concepts as a way to cope with decreasing revenue and ever tighter profit margins. It also is likely that lean construction concepts have been widely embraced by firms wishing to improve their sustainability.

Despite its current popularity, however, only a small number of contractors (18%) that aren't currently using lean construction concepts say they plan to implement these measures during 2011. This may be a result of a desire to see whether revenue and profit margins increase, releasing pressure on the need to cut costs.

Regional Market Trends

Regional market trends vary widely among the 26 states with a large enough sample size to merit individual outlooks for this year. No single region had a monopoly on positive expectations, while gloomy predictions could also be found from coast to coast. Despite this variety, it appears pretty clear that contractors in Idaho, Nevada and South Carolina are not overly optimistic (except for contractors in South Carolina's Manufacturing segment), while the overall outlook looks relatively positive in Iowa and Massachusetts for many market segments.

The employment picture reflects the varied outlook, with 45 percent of firms in Iowa planning to hire, more than in any other state. Those firms plan to hire an average of 5 employees each, 21 percent of their workforce. Only 5 percent of Iowa contractors plan layoffs. Meanwhile, 48 percent of firms in Idaho plan layoffs for this year, the highest percentage from any state. Those firms plan to lay off an average of 12 employees each, 11 percent of their workforce. Only 14 percent of Idaho firms say they expect to hire in 2011.

Contractors in Kansas are the most optimistic about growth for the Highway market, with 43 percent of firms saying they expect an increase in highway funding for 2011. This no doubt reflects the impact of a statewide initiative enacted in 2010 to increase highway and transportation funding. In contrast, 89 percent of contractors in South Carolina expect there to be less highway funding in 2011 than there was in 2010, the most pessimistic result for any state.

Firms that work in the Other Transportation category, which includes transit and airport construction, are most optimistic about 2011 in Colorado, where 36 percent expect the market to grow, perhaps because of work planned by Denver's Regional Transportation District. Once again, more contractors in South Carolina (80%) expect this market segment to shrink this year than in any other state.

Contractors who report working in the Water/Sewer market are the most optimistic about this year in Iowa, where 43 percent expect the market to expand. However, 80 percent of contractors in Idaho, more than from any other state, report they expect the market segment to contract in 2011.

Regional expectations for the Power market vary greatly, with more contractors in California (51%) expecting the market to expand this year than in any other state. Meanwhile, 88 percent of contractors from Idaho expect this market to contract in 2011, more than in any other state.

South Carolina contractors are the most optimistic about the Manufacturing segment, with 50 percent saying they expect it to expand this year, and none predicting that market will shrink. Meanwhile, 75 percent of contractors working in the Manufacturing sector in Nevada expect that market to shrink in 2011, more than in any other state with a large enough sample size.

A higher number of Ohio-based contractors (58%) expect the Hospital/Higher Education market to improve in 2011 than in any other state. In contrast, 81 percent of contractors working in the Hospital/Higher Education market in Utah expect the amount of money invested in those projects this year to decline, more than in any other state.

The Retail/Warehouse/Lodging sector outlook for 2011 looks relatively bright in South Carolina, where 40 percent of contractors working in that market expect activity to increase, more than in any other state. In contrast, 86 percent of contractors from Nebraska working in that segment of the market expect construction activity to decline this year.

Massachusetts-based contractors are the most optimistic about the Public Building sector for 2011, with an industry-leading 38 percent reporting they expect activity to increase this year. Contractors in Idaho, however, are the most pessimistic about the Public Building outlook, with 69 percent reporting they expect that market to decline and none reporting an expected increase in activity.

Likewise, Massachusetts-based contractors are the most optimistic about Private Office construction activity in 2011, with 44 percent reporting an expected increase in activity in that market. Contractors in Nevada are expecting the biggest decline in Private Office construction, with 88 percent reporting an anticipated decline in spending in that market segment this year.

And continuing the trend of Bay State optimism, Massachusetts-based contractors are more optimistic about the chances for growth in the K-12 construction market than in any other state, with 29 percent expecting the market to improve in 2011. Idaho's relatively bleak outlook continues with 90 percent of contractors based in that state reporting they expect a decrease in construction spending for this year, more than in any other state.

Conclusion

While the outlook for the construction industry is certainly brighter in 2011 than it has been for the past two years, 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. Working against the industry is overall weak demand, stagnant equipment orders, rising health care costs and the fading benefits of the stimulus. When all those factors are considered together, it means the industry is in for a year that is likely to start tough and get slowly and steadily better throughout the year.

Public officials and policy makers can encourage a construction turn-around by enacting measures designed to stimulate new private sector demand while maintaining public infrastructure. Acting on long-delayed infrastructure bills to address water, highway, transit and airport infrastructure will certainly help address concerns on certain construction market segments. These investments will also help the broader construction community by stimulating broader private sector activity.

Washington and state officials should also look at current regulatory and tax policies with an eye towards eliminating measures that needlessly restrain construction demand. Environmental permitting for many types of construction projects is often measured in terms of years, instead of the weeks or months that most market cycles demand. Meanwhile, it is clear that additional steps need to be taken to address the threat of rising health care costs for the vast majority of construction employers.

Despite these challenges and the need for supportive measures from public officials, there is every reason to believe that the construction industry that emerges from today's difficult environment will be more efficient, more productive and even better suited to help build the modern, green economy most Americans demand. Firms are investing in better technology. They are perfecting green building techniques. They are looking at new ways to coordinate on complex projects. And they are finding ways to make their operations more cost efficient and more sustainable. The impact they will have on improving the construction industry is likely to be as long-lived as it is broad-based.

In short, it is a very challenging time to be in the construction industry. Yet it is also a very exciting time, one that is likely to be marked as a transition point that creates the foundation for new growth and prosperity.

About the Survey

AGC and Navigant conducted the survey that serves as the basis for the 2011 Construction Hiring and Business Forecast in December and early January. Nearly 1,300 firms – primarily from among the 20,000 general contractor or specialty subcontractor members of the Associated General Contractors of America – completed the survey.   Contractors were not compensated or in any other way reimbursed for the survey.

Respondents came from all areas of the country, with the West most heavily represented (27%); followed by the Southeast (24%); the Midwest (22%); the Southwest (18%); and the Northeast (9%).   Firms from the District of Columbia, Puerto Rico and every state except Delaware participated in the survey. The most responses came from Texas (163), California (95), North Carolina (77), Colorado (44) and Washington (43).

Participation in the survey also was robust among contractors from all segments of the construction industry. The smallest segment represented in the survey was power construction, with 450 respondents reporting they work in that field. Moving up from there, 550 respondents reported working in water/sewer construction; 562 in highway construction; 643 in manufacturing construction; 813 in K-12 schools, 845 in retail, warehouse and lodging structures; 867 in hospital/higher education construction; 909 in private office buildings; and 918 in public structures.