

The Garrison Report #2009-1 (The Report on Strategic Thinking)

5 Predictions for 2009

Are You Prepared to Take Advantage of Them?

#1—U.S. Economy

The U.S. recession is only going to get worse with a decline in gross national product of more than 1 percent in 2009 and unemployment reaching double digits.

Despite nearly a trillion dollars from a so-called stimulus package, the economy will continue to falter because the package is ill conceived and doesn't do what's needed to create jobs. Instead Congress is hiding behind the need to do something to fund many of its pet projects that will create very few, if any, jobs. Unfortunately, much of the stimulus package will start to make an impact when the country is already coming out of the recession, and this may lead to inflation as we saw in housing prices in 2003–2005.

Worse for the construction industry, much of the money dedicated to infrastructure is for projects that will take time to get into construction because they are not shovel-ready projects.

Having spent the past few months talking to industry leaders, economists and others with their ears to ground, I will attempt to predict the construction industry's future for 2009. Recently I spoke with Ken Simonson, AGC Chief Economist, and I agree with his conclusion that when the nation comes out of the current recession, the construction industry will be different.

The question is this: How will it be different?

#2—Residential Construction

My prediction is that new housing sales will remain at depressed levels through 2009. During the first half of 2009, new housing starts will remain below 600,000 in average annual sales. Some areas of the country will do better, but areas such as California, Florida and Nevada that experienced rapid large growth in recent years will continue to have almost nonexistent markets. The reason is it is virtually impossible for homebuilders to compete with the drastically reduced foreclosure properties that heavily impact these areas.

At the end of the third quarter 2008, only 56.1 percent of families could afford the national median price for a house of \$206,000. This is the highest level in more than four years, but it's still below normal historic levels in the '60s. Worse, these figures were before the economic crisis reared its ugly head and the start of massive layoffs. The economy lost 2.6 million jobs in 2008, of which 1.5 million were in the last quarter, the most since 1945, so this will continue to suppress demand.

Existing house sales increased during November, but sale prices drop significantly. This condition will place greater pressure on homebuilders to reduce their costs, but they can't do that unless they eliminate the waste that is in the process. The good news is the recession will bring down materials costs, but unless the industry eliminates its significant

waste, most builders will not be able to reduce their costs enough to improve their situation. A bailout or tax credits for first-time buyers will not solve the inherent problem in the industry that housing prices are too high compared to what people can afford. There will be little growth in new house sales until incomes rise, and that seems unlikely in the near future when one considers the economic situation, or homebuilders face the fact that they must eliminate waste in their systems.

The good news is those homebuilders that get the message and learn how to remove the waste from their processes will be able to offer affordable housing and will get more than their share of business. Those that continue to pursue the business as usual will probably disappear unless they have deep pockets.

#3—Nonresidential Construction

Nonresidential construction will go down between 5 and 10 percent in 2009.

Despite the credit crunch, the Census Bureau's revised report indicates that the three months ending in November actually saw an increase in construction expenditures compared with the three prior months. Construction spending in November totaled \$1.078 trillion at a seasonally adjusted annual rate, but the impacts of the deepening recession are going to start taking their toll.

The combination of a credit crunch, a decline in manufacturing, large numbers of retail closures and declining hotel occupancy will force cutbacks in capital spending. These impacts will force construction expenditures down to between \$900 billion and \$950 billion. Unfortunately, the stimulus package is just not going to have a significant impact in the short term for the construction industry.

#4—Infrastructure

What may shock some is that I predict that infrastructure work is going to be down during the first half of the year. It may recover to prerecession levels in the second half of the year depending on the actual projects funded in the stimulus package.

First, states are cutting back on capital expenditures because of their budget problems, so the financing of infrastructure will fall more heavily on the federal government. In the fog of Washington, it is difficult to determine exactly where the stimulus money will be going, but after my initial optimism about President Obama's commitment to infrastructure, there appears to be more business as usual. Depending on whose figures you look at, the infrastructure needs an additional \$300 billion to \$500 billion a year in expenditures above 2008 levels. So while any additional money spent on infrastructure is good, it comes in degrees.

As a stimulus package, it should focus on shovel-ready projects in order to maximize its impact on the economy. A press release on December 16, 2008, by the AGC stated, "Personal earnings will increase by \$1.1 billion and the national gross domestic product will increase by \$3.4 billion for every billion dollars invested in new infrastructure projects." They also added that for every billion dollars invested in projects "more than 28,500 jobs will be created or saved nationwide." However, to receive these benefits in 2009, the commitment in funds must translate into projects that can start immediately.

Also, the cost of not fixing the problems could be even greater. For example, the Department of Transportation estimates that traffic congestion costs Americans \$200

billion a year. To receive the maximum benefit to the nation, we must focus on projects with the highest return on investment, not some congressman's pet project.

I disagree with those who argue that infrastructure work will take up to 18 months to start taking effect. The St. Anthony Falls Bridge in Minneapolis was a \$230 million replacement bridge that was completed in 13.5 months from the date the original bridge collapsed. The key is for government to work with the industry in a collaborative way to maximize the use of the available funds. Integrated project delivery methods have proven they can deliver maximum value to communities. For example, the aggressive schedule of the Flatiron-Manson team on the Minneapolis bridge saved the community more than the cost of the bridge.

The financial crisis I predict will force more government agencies to consider the use of public-private-partnerships. Not only does this increase potential capital, but Peter Luchetti of Table Rock Partners says that P3 projects cost the tax payers about 18 percent less. This approach is essential considering the huge capital investments that are needed.

#5—Time of Opportunity

Despite the first four predictions, I don't predict doom and gloom for the entire construction industry, just those that aren't prepared for the changes that are coming. In fact, I predict that companies that know what to do and act on those opportunities will have a relatively good year and be primed for growth when the recession winds down.

Winston Churchill said, "A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty." I see evidence that well-run companies see the opportunities to better serve their clients. These companies focus on value, and in a crisis clients typically are more concerned about the value received.

During recent interviews with Charlie Bacon, President and CEO of Limbach Facility Services, and Steve Halverson, President and CEO of the Haskell Company, there was a common theme. They said they couldn't stop investing in the development of their people or technology that would help leap forward when the recession ended. It's this kind of forward, positive thinking that will hold companies in good stead during the recession.

Of course, they reported that companies need to act smart by not wasting resources and focusing on keeping receivables under control. But successful companies focus on the positive, not the negative. Contractors that do the latter will struggle during the recession and may even perish.

Those companies that prosper during the recession and position themselves to surge out of it will do several things. They will focus on LEED construction and retrofits, place greater emphasis on collaboration through integrated construction processes, and invest in proven technology such as BIM to help operate more efficiently and effectively.

In the end it will be about value. Those companies that focus on maximizing the value to their clients will not only survive, but thrive. This is true in a recession or a boom.

* * * * * **THE END** * * * * *

