TENTATIVE SIGNS OF A RECOVERY: THE 2013 CONSTRUCTION HIRING AND BUSINESS OUTLOOK

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Summary

After six years of a construction downturn that has cost more than 2 million jobs and turned a $1.2 trillion-a-year industry into an $800 billion-a-year one, the outlook for construction hiring is once again heading in the right direction. Significantly more firms are planning to add staff in 2013 compared to firms planning to reduce staff. Many segments of the private construction sector look poised to expand this year, and a strong number of firms finally appear confident enough about market conditions to attempt to charge more for construction services.

As welcome as the generally more upbeat outlook appears, many firms are still facing significant economic headwinds in 2013. Most firms expect the public sector construction market to continue to shrink and are less optimistic about the outlook for manufacturing than for other private sector segments. Firms remain reluctant to make large scale equipment purchases, preferring instead to lease. Health care costs continue to climb steadily even as the prices firms pay for construction materials are expected to rise. Perhaps that explains why most firms don’t expect the industry to truly recover until 2014, at the earliest. Overall responses varied little, no matter what business segment contractors said they predominantly worked in.

Some Private Improvement Predicted, But Public Sector Looks Bleak

There are two distinct trends emerging in the construction outlook. On one hand, there is growing optimism among contractors about key segments of the private sector market. Meanwhile, contractors are generally more pessimistic about the outlook for public sector demand. Contractors are most optimistic about the outlook for hospital and higher education construction, with 36 percent of firms predicting the amount of money spent on those projects will grow in 2013, vs. 26 percent of firms predicting a decrease, for a net positive reading of 10 percent. Contractors are also relatively optimistic about the market for construction of power facilities in 2013, with 32 percent of firms reporting they expect activity levels to increase in that market segment during the year, compared with 27 percent that expect a decrease, for a new positive reading of 6 percent (based on unrounded shares). For other private segments — retail, warehousing and lodging; private office; and manufacturing — between 23 and 26 percent of firms expect growth in 2013, while 32 to 34 percent of respondents expect these segments to shrink.

Meanwhile, contractors have relatively bleak expectations for a number of public sector market segments. For example, 40 percent of contractors report they expect the public building market to shrink in 2013 while only 18 percent expect that market to expand — a net difference of -22 percent. Similarly, 37 percent of contractors report they expect the K-12 school construction market will shrink this year while only 20 percent expect that market to grow — a net of -17 percent.

Contractors have mixed views about the public infrastructure market, however. Contractors were nearly evenly divided regarding the outlook for water and sewer construction, with 25 percent expecting an increase in 2013 and 28 percent a decrease, for a net reading of -4 percent (from unrounded results). As for the much larger highway market, 21 percent said they expected growth in 2013, vs. 34 percent who expected a decline, a net reading of -14 percent. Worst of all were expectations for the "other transportation" market — airport and transit construction primarily — with only 16 percent expecting a rise in 2013 and 34 percent a drop, for a net reading of -17 percent.

Outlook for Construction Employment is Improving

Significantly more firms (31 percent) plan to add staff this year than plan to lay off staff (9 percent), for a net positive reading of 22 percent. This is a clear, but not overwhelming, improvement from 2012 when 31 percent of these firms reported cutting staff and 37 percent added employees — a net positive of only 6 percent. Although more firms plan to hire employees this year than to reduce staff, those additions are likely to be modest at best. Of the firms that report plans to increase headcount in 2013, 79 percent plan to add 15 or fewer new employees in 2013 while only 13 percent expect to hire more than 25 this year. Last year, in contrast, 66 percent of contractors that added staff expanded by 15 or fewer people while 22 percent added more than 25 new employees.

Fortunately, the firms planning to cut staff also expect to make relatively modest changes to the size of their workforce. Ninety-one percent of those firms estimate their planned layoffs will amount to 15 or fewer positions being cut. For most of the firms anticipating staff reductions — 92 percent — these layoffs will shrink their total workforce by 25 percent or less. Those layoffs would be smaller in scope than what occurred in 2012, when 22 percent of firms reported reducing staff by 16 or more people for the year.

Tight Credit is a Problem, But Appears to be Getting Better

While relatively few firms report having problems getting bank loans compared to a year ago, a significant — but smaller than last year — number of firms report a number of their customers' projects have been delayed or cancelled because of tight credit conditions. Specifically, only 13 percent of firms reported having a harder time getting bank loans compared to a year ago. However, 40 percent of firms reported that tighter lending conditions have caused customers' projects to be delayed or cancelled. And while only 3 percent of firms reported having an easier time getting credit, a full 41 percent report that credit conditions are essentially unchanged compared to a year ago.

Firms More Likely to Lease Equipment Instead of Buying It

While overall demand for new construction equipment is likely to remain relatively modest in 2013, slightly more firms plan to lease equipment this year than purchase it, reflecting continued caution among hard-hit firms. Specifically, 64 percent of firms plan to purchase some kind of construction equipment this year while 77 percent of firms plan to lease new equipment in 2013. Among firms planning to purchase equipment, more than two-thirds report plans to purchase $250,000 or less worth of equipment. Similarly, 73 percent of firms plan to lease equipment worth $250,000 or less during 2013.

Significantly, the equipment outlook for 2013 appears slightly lower than in 2012. Last year, 70 percent of firms reported purchasing new construction equipment, compared to 64 percent for 2013. While 27 percent of firms reported purchasing more than $250,000 worth of new equipment last year, only 21 percent of firms plan to invest as much this year. And 78 percent leased new equipment last year while only 77 percent plan to lease new equipment this year. Likewise, 23 percent of firms leased more than $250,000 worth of equipment last year while only 20 percent of firms plan to lease that much in 2013.

Highway contractors clearly have a larger appetite than other contractors for purchasing new equipment in 2013, with 79 percent reporting plans to purchase in 2013. In contrast, all segments reported similar likelihood of leasing equipment in 2013.

Contractors Continue to Be Squeezed By Rising Health Care Costs

Construction firms expect to continue to spend more to provide health care for their employees in 2013, even though the vast majority of firms reported paying more for health care coverage last year. Three-quarters of all firms reported paying more for health care coverage for their employees in 2012 while only 16 percent reported paying the same amount and only 3 percent reported paying less for health care last year. Meanwhile, 77 percent of firms expect to pay more to insure their employees in 2013 while only 12 percent expect to pay the same as they did in 2012 and only 2 percent expect to pay less. Significantly, no firm said they expected to offer more health care coverage in 2013 compared to 2012.

There was little distinction among contractor types when it comes to paying more for health care in 2012 and 2013. However, by a slight amount, more power contractors appear to be suffering from higher health care costs, with 77 percent reporting they paid ore in 2012 and 78 percent reporting they expect to pay more in 2013.

Contractors Planning to Pass Along Some Materials Prices Increases

An overwhelming majority of firms reported paying more for construction materials in 2012 than they did the previous year, a trend that firms predict will continue into 2013. Eighty-eight percent of firms reported paying more for construction materials in 2012 compared to the previous year, while 90 percent report they expect materials prices to again increase in 2013. The majority of firms, perhaps fortunately, reported price increases ranging between 1 and 10 percent (72 percent in 2012 and 71 percent in 2013) while relatively few (2 and 3 percent respectively) experienced or expect increases of 25 percent or more.

On a more positive note, construction firms appear more optimistic about their ability to increase what they charge for construction services in 2013 compared to 2012. While 47 percent of firms report that they lowered their bid levels in 2012 and only 15 percent were able to raise them, 28 percent of firms expect to raise bid levels in 2013 and only 14 percent expect to lower them. This indicates contractors are more optimistic about their ability to pass along some of the increases in materials and health care costs that they have been eroding their profit margins the past several years.

In a noticeable turnaround from previous years, retail, warehouse & lodging contractors are more optimistic about their ability to raise bid levels than any other type of contractor, with 29 percent planning to charge more in 2013. Conversely, highway contractors appear the most pessimistic about bid levels, topping the list of firm types that plan to lower bid levels in 2013 at 17 percent.

The Construction Market Will Grow Again… Next Year

While there are signs of growing optimism among contractors about some aspects of their business, the bottom line is that only 20 percent of firms say they expect the overall construction market to grow in 2013, while 56 percent don't expect it to grow again until at least 2015. Even though few firms expect the market to grown again in 2013, more manufacturing contractors expect growth in 2013 than any other market types, with 21 percent predicting growth this year. Water and sewer contractors will have to be more patient than other contractors, with more of those firms predicting the recovery will not arrive until 2016 (25 percent) than any other firm type.

Building Information Modeling and PPPs Are Here to Stay

Based on the results from this year's survey, it is pretty clear that Building Information Modeling (BIM) is here to stay. Firms reported using BIM technology in 38 percent of their projects in 2012, a slight increase compared to the 35 percent of firms that used BIM in 2011. BIM technology typically uses three-dimensional, real-time, dynamic building modeling software to increase productivity in building design and construction. Construction firms clearly expect demand for BIM to continue growing, with 43 percent reporting they expect use of BIM to increase in 2013. Meanwhile, only 1 percent of firms expect the use of BIM to decrease this year. 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.

Likewise, Public Private Partnerships, which leverage private sector capital to help finance public projects, are increasingly becoming a reality for many construction firms. And while the scope is smaller than with BIM, the practice is clearly set to grow. Thirty-seven percent of firms report being involved in public private partnership projects in 2012 while 97 percent of firms expect the amount of PPP work to increase or remain constant in 2013. The growth in use of public private partnerships is likely being driven by tight local, state and federal budgets for infrastructure and construction that are forcing officials to find creative ways to finance needed developments.

Interestingly, PPP use appears most common on power projects, with 43 percent of power contractors reporting having worked on a public private partnership in 2012. Meanwhile contractors were very consistent, regardless of market segment, in their belief that the amount of PPP activity will either remain steady or grow in 2013, while 97 percent of contractors agree that PPPs are here to stay in comparable or higher numbers next year.

Green Construction is No Longer Red Hot

After years of growing demand for "green" construction projects — projects seeking one form of environmental performance certification or another — most firms do not expect demand for these kinds of projects to grow in 2013. Sixty percent of firms expect demand for green projects to stagnate in 2013 while another 5 percent expect to see fewer green projects this year. This follows a year when 57 percent of firms reported that green construction represented anywhere between 0 and 5 percent of their total workload. In addition, declining demand for public structures is likely to impact demand for green projects since governments have been among the most aggressive purchasers of green structures so far.

Most Firms Expect to Make Significant IT Investments in 2013

Most firms (60 percent) report they plan to make significant investments in their information technology departments in 2013. Seventy-three percent of firms report they expect to invest over $10,000 in new information technology this year. Meanwhile, a relatively small percentage of firms (11 percent) report they plan to purchase new financial and job cost software in 2013. Yet, 76 percent of the firms planning to purchase such software report they plan to invest more than $10,000 on those purchases, with 35 percent reporting plans to invest over $50,000. Similarly, only 9 percent of firms plan to lease or finance the purchase of new financial and job cost software in 2013. Yet, among those firms, 57 percent plan to spend over $10,000 on leasing or financing the software. In other words, despite ongoing market challenges, many firms report they are willing to invest significant sums to upgrade their overall technology while a select few will make large investments designed to make their back-office functions more efficient. As firms look for ways to survive six years of tough economic conditions, a significant percentage appear to appreciate that investing in greater efficiency is an effective way to cut broader costs and become more competitive.

Regional Market Trends

Among the 30 states with large enough survey sample sizes, 56 percent of firms in Maryland plan to hire, more than in any other state. Conversely, only 14 percent of firms plan to hire new staff in South Carolina, the least amount of any state. Meanwhile, 37 percent of firms in Michigan plan layoffs for this year, the highest percentage of any state and no firms report planning layoffs in Maryland this year.

More broadly, the employment outlook does vary based on region. A higher percentage (42 percent) of contractors working in the Northeast report plans to add new staff this year, while only 24 percent of contractors working in the South plan to add new staff, the smallest percentage. A higher percentage of contractors working in the Midwest plan layoffs this year (15 percent) than any other region of the country, while only 7 percent of contractors working in the Southwest plan layoffs, the smallest percentage.

Likewise, there are some significant variances in contractors' expectations for growth in various market segments this year. For example, contractors in the Southwest and Northwest are more optimistic about the outlook for highway construction this year, with 32 percent of contractors expecting the market to increase in the Southwest, vs. 31 percent expecting a decrease while 31 percent of contractors in the Northeast expect an increase and 30 percent a decrease, for a net positive of 1 percent for each region. Conversely, contractors in the West are the most pessimistic about the highway market, with only 12 percent expecting demand to grow in 2013 while 40 percent expect it to shrink, for a net reading of -28 percent.

More Northeastern contractors expect the market for "other transportation" construction to improve this year, with 29 percent expecting an increase and 21 percent expecting a decrease, for a net positive of 8 percent. On the other hand, contractors in the South and West are equally pessimistic about the market segment for the year. Only 13 percent of contractors in the West expect the market to grow while 37 percent expect it to shrink while 14 percent of contractors in the South expect the market to grow and 38 percent expect it to contract — a net reading for both regions of -24 percent.

Northeastern contractors are also the most upbeat about the market for water and sewer construction. Thirty-nine percent of the region's contractors expect that market to expand this year while only 16 percent expect it to decline, a net reading of 23 percent. Southwestern contractors have the lowest expectations for the market segment with 18 percent predicting it will expand and 38 percent predicting it will shrink, a net reading of -20 percent.

The Midwest has the largest concentration of contractors that are optimistic about the market for power construction in 2013. Thirty-six percent of that region's contractors expect activity will increase while only 17 percent expect it to decrease, a net positive of 19 percent. Contractors is the South, in contrast, are the least optimistic, with only 19 percent expecting that market to increase and 35 percent expecting it to increase, a net reading of -16 percent.

While the outlook for manufacturing is far from upbeat, more contractors in the Midwest expect the market to expand than elsewhere, with 27 percent predicting an increase and 35 percent predicting a decrease, a net reading of -8 percent. In contrast, contractors working in the South have the worst outlook for manufacturing construction, with 16 percent expecting an increase and 40 percent expecting a decrease, a net reading of -24 percent.

Contractors in the Midwest are also the most optimistic about prospects for the hospital and higher education market. Forty-one percent of contractors in that region expect the market to expand while 22 percent expect it to shrink, a net positive of 19 percent. Conversely, more contractors in the West expect the market for hospital and higher education construction to decline in 2013, with 22 percent predicting an increase and 33 percent predicting a decrease, a net reading of -11 percent.

Retail, warehouse and lodging construction appears the most promising this year in the Southwest. Thirty-six percent of contractors there expect the market to improve, while only 29 percent expect it to decline, a net positive of 7 percent. Contractors working in the South, meanwhile, do not expect as much activity in that sector this year. Twenty-two percent expect it to increase while 37 percent expect it to shrink, a net reading of -15 percent.

Within the overall negative outlook for public buildings, contractors in the Southwest appear set to suffer the least, with 23 percent expect the market to improve and 33 percent expecting the marking to deteriorate, a net reading of -10 percent. Once again contractors in the South appear headed for a difficult year, with 14 percent expecting demand for public buildings to improve and 50 percent expecting it to decline, a net reading of -36 percent.

Private office construction looks set to expand slightly in the Northeast, with 28 percent of contractors there predicting activity will increase in 2013, vs. 26 percent expecting it to decrease, a net positive of 2 percent. Southern contractors are have a bleak outlook for private office demand — only 14 percent expect an increase in activity while 43 percent expect a decrease, a net reading of -29 percent.

And while the K-12 school construction market also fares poorly in this year's outlook, Northeastern contractors are more optimistic than their regional counterparts. Twenty-eight percent of contractors there expect demand to improve in 2013 while 32 percent expect demand to decline, a net reading of -4 percent. Southern contractors, again, are the least optimistic. Fifteen percent of contractors in that region expect an increase in K-12 school construction, vs. 47 percent who expect the market to decline, a net reading of -32 percent.

Looking more broadly, contractors working in the Midwest, Southwest and Northeast appear significantly more optimistic about the year than do their counterparts working in the West and the South. Southern contractors in particular are predicting a difficult year, with the least optimistic outlook in 7 of 9 market segments tracked in this year's Outlook. Meanwhile, Northeastern contractors appear the most optimistic, with the most optimistic expectations for five of the nine market segments we track.

Conclusion

While the outlook for the construction industry appears to be heading in the right direction for 2013, many firms are still grappling with significant economic headwinds. Growing demand for certain types of private sector projects, plans to expand payrolls, relative stability in transportation markets, increasing willingness to raise bid prices and growing embrace of new technology and new business practices are clear signs the industry is ready to emerge from a years-long downturn.

But for every sign of optimism, there are causes for concern. Demand for public buildings and facilities is expected to decline, demand for manufacturing facilities appears to be slackening, materials prices and health care costs continue to rise, firms remain reluctant to invest in new equipment, and most contractors don't expect a full recovery until at least 2014. In other words, the chances the industry will expand and improve in 2013 are real, but fragile.

With many segments of the private sector construction market doing relatively well, federal officials should continue to find ways to support broader economic growth. The greater tax certainty that came with the deal to address the fiscal cliff will help, but more needs to be done. Most important, Congress and the administration need to resolve the kind of out-of-control entitlement spending that is overwhelming the federal budget and forcing cuts to vital infrastructure projects needed to keep the economy running efficiently.

Curbing out-of-control entitlement spending and getting the federal deficit back under control will help ease the series of fiscal “crises” that appear to be consuming more and more of the political agenda. Eliminating those recurring fiscal fights will provide even more certainty and stability to the private sector, ultimately leading to greater demand for new projects and more widely available credit for developers.

In addition, Washington and state officials should look at current regulatory and permitting policies and find ways to eliminate or streamline measures that needlessly restrain construction demand. It often takes years before government officials are willing to make a decision about whether vital construction projects can move forward. As a result, it is almost impossible for planners and developers to meet the needs of fast-evolving market and demographic trends.

Political leaders should also continue to find ways to make it easier to use private capital to help finance public projects. Given the realities of the current federal budget situation, government officials at all levels are going to have to become increasingly creative in their efforts to finance projects needed to address growing demand for schools, infrastructure and public amenities like parks and recreation facilities. Yet, the current patchwork of state and federal legislation and their varying restrictions on public private partnerships is likely keeping a lot of capital out of the market.

Even though there are many reasons for optimism about the outlook for 2013, there are also plenty of causes for concern. Yet contractors appear poised to continue finding ways to make the most out of difficult economic conditions. With luck and a lot of work, the end of 2013 will find the hard-hit construction industry relatively larger, healthier, more technologically savvy and more profitable than it is today.

About the Survey

AGC and Computer Guidance Corporation conducted the survey that serves as the basis for the 2013 Construction Hiring and Business Forecast during the final two weeks of November and first three weeks of December 2012. Over 1,300 firms from D.C. and every state except for Delaware — primarily from among the 20,000 general contractor or specialty subcontractor members of the Associated General Contractors of America — completed the survey. Contractors who completed the survey were entered into a raffle to win a $100 Amazon gift certificate. Other than that, firms and their employees were not compensated or in any other way reimbursed for completing the survey.