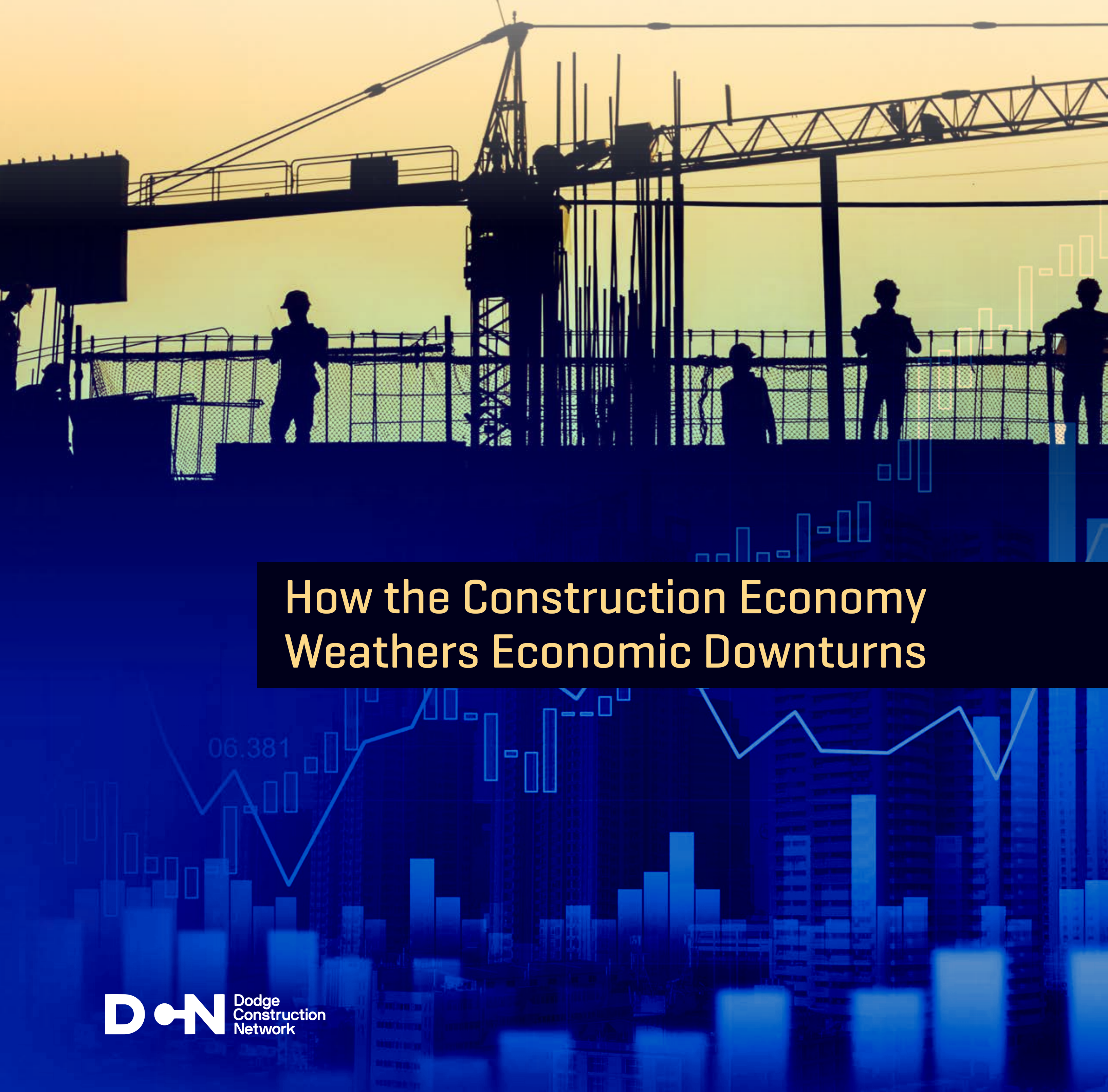
Momentum Amid Uncertainty:

DCN Q2 Report



How the Construction Economy Weathers Economic Downturns

Dodge Construction Network

Welcome to the first edition of Dodge Construction Network's Quarterly Report. Informed by its latest rich data and insights, and analytical commentary from the company's Chief Economist, Richard Branch, Dodge Construction Network's newest report aims to highlight trends throughout the construction industry on a quarterly basis and provide analysis on the quarters to come.

With Q2 in the rearview mirror, commercial construction's leading challenges are a tenuous economic landscape and shrinking workforce. The Infrastructure Investment and Jobs Act (IIJA) is a ray of opportunity for the construction economy with funds aimed at addressing pressing needs ranging from aging transportation infrastructure to expanding broadband internet access.

Every industry experienced economic challenges including inflation, rising energy and material costs, and increasing interest rates in Q2 2022. Growth during Q2 of 2022 hit double digits across single and multifamily housing starts, but only rose by 2% and 4% respectively as a result of these broader economic challenges. Adjusting for inflation, even the commercial sector is only projected to increase by 6% during all of 2022.

Even accounting for these looming macro- and socio-economic factors, the construction industry's trajectory remains positive. This is primarily due to the large number of projects currently in the planning backlog. The Dodge Momentum Index (DMI), issued by Dodge Construction Network, an industry leading monthly measure of the initial report for nonresidential building projects in planning, sits close to a nearly 14-year high as a result.

Construction Growth Reliant on Continued Trends

Though the pipeline looks promising, there are strings attached. Two things must continue into Q3 for the progress of construction to keep trending upward: decreased impact from the pandemic and successful mitigation of over-inflation.

Shocks From the Pandemic Must Decrease

For projections connected to the pandemic to continue, each new wave of the COVID-19 variant will need to impact the economy less and less. Nonresidential construction has benefited from the growing confidence that the worst of the pandemic is in the rear-view mirror, and the pipeline of projects waiting to start continues to fill, suggesting this trend will continue.

Striking a Balance Between Inflation and Interest Rates

Upward trends involving the US economy require The Federal Reserve to successfully combat inflation by raising interest rates without sending the economy into a recession.

"What's worse than high inflation and low unemployment is high inflation and a recession with millions of people out of work," said Branch. ***"The federal government is tasked with striking a delicate balance here."***

The Federal Reserve indicated consumer price inflation rose from 5.8% in December of 2021 to 6.3% in April, marking its highest level since the early 1980s – far surpassing the Federal Open Market Committee's goal of 2%. Most recently, The Federal Reserve increased its benchmark interest rate by 75 basis points to a range of 1.5%-1.75% in June, representing the biggest increase since 1994. Chair Jerome Powell indicated we may see continued rate increases in July if pressures continue to mount.

"Inflation and rising costs are a huge concern for the construction industry, right up there with our workforce shortage. Beyond just the cost of materials, there's also a hidden cost in the price of gas as it relates to how we fuel our machinery. The positive here is that it appears that the prices have peaked, improving the calculus of the 'go or no go' of the decision. With that, as we view projects waiting in the pipeline to break ground, it gives us hope that those projects can commence in late 2022 or 2023. The negative here is that inflation is dangerously high, and the federal reserve has taken an aggressive approach to combating it. While this remedies some aspects of the issue, it can slow the economy down. This can further counter the calculations required to bring projects out of the pipeline," said Branch.

Addressing Construction's Dwindling Workforce

Another burden on the industry, exacerbated by the pandemic, is the scarcity of skilled construction workers. As a result, unfilled positions in construction are approaching an all-time high.

There are roughly 334,000 unfilled positions in the construction industry, according to the US Bureau of Labor Statistics, a trend that has been moving aggressively upward since the spring of 2020. This trend has plagued construction's growth for years and has significantly worsened over time. Employment as it relates to construction is systemic — it's a clear and present danger as the industry moves forward. The industry must reach younger workers where they are (high schools, tech schools and universities) with opportunities that present a path to a career, not just a job.

"We expect that the shortage of skilled labor will slow the progress of projects through the design and bidding stages, resulting in moderate growth in starts activity," said Branch. ***"This is the perfect storm. We have not recently had a situation like this — where we have significant logistics and supply issues caused by the pandemic combined with the shortage of employees in logistics and trucking. It's unprecedented."***

Despite the uptick in jobs anticipated to follow the Infrastructure bill, there remains a significant near-future shortage – one that may be further hindered during the time it takes to develop trade-specific workers. Office projects currently are taking about nine months longer to get from conception to groundbreaking than they were prior to the pandemic. To combat this issue, construction owners should consider the efficiency and productivity enabled through digital transformation:

"Design procedures, digitization of plans and even robotics are enabling construction workers to get more done in less time, and allowing them to spend more time doing more complex tasks in the construction space. Solutions that make job sites more productive serve to mitigate some of the challenges connected to the workforce shortage," said Branch.

The Infrastructure Bill: Where the broadband meets the road

President Joe Biden signed the $1.2 trillion IIJA into law on Nov. 15, 2021. As a result, infrastructure remains a positive area within the construction sector as money from the IIJA begins to hit the market. In spite of the shortages of labor and high prices, projects are being funded and beginning to break ground.

The construction industry is well-positioned to make further gains fed by this growing pipeline of nonresidential projects waiting to break ground and this cash infusion directed towards infrastructure. Despite the funding directed to address America's infrastructure, innovative approaches that introduce more efficiency into the way projects are contracted, financed and delivered remain a top priority. Current data doesn't show an immediate impact yet, and the positive trends and innovation from this funding will likely be more apparent within the next few quarters.

Transportation

The Infrastructure Law reauthorizes federal surface transportation programs for five years. It aims to invest nearly $400 billion to fix roads and bridges both regionally and nationally — boosting job opportunities across higher-paying union positions and facilitating a more resilient transportation sector.

Amtrak's Gateway Program located in the Northeast corridor stands out as a major target for this funding with plans to replace the 100-year-old North River Tunnel section. These century-old tunnels bottleneck high-speed rail capacity in the region. Targeting aging infrastructure like this serves to improve much needed safety and reliability across our national supply chain and expand goods and services facilitating growth outside of major metropolitan areas, and with it, introducing more commercial construction opportunities to these areas.

A Catalyst for Transformation: Information Highways

One of the most transformative uses for IIJA funding is directed at expanding our nation's broadband internet infrastructure. With a more robust broadband network, smaller and rural construction firms will have access to more data and digital processes that have only been available to the larger firms historically– the sandbox is larger, and more people can now play. As the nearly $65 billion allocated to expanding our information highways takes effect, cloud computing, AI and advanced data sets critical for tracking the movement of personnel, materials and machinery across the job site will likely be more abundant.

"This technology is critical to increasing productivity by way of efficiency, and improving safety and onsite operations," said Branch.

Conclusion

Commercial construction is navigating a challenging economic environment impacted by the tail end of the global pandemic and the looming uncertainty of inflation and rising interest rates. The industry is bolstered by a backlog of projects waiting to break ground on both the commercial and residential sectors but is still navigating a workforce shortage that threatens to dampen those projects getting off the ground.

The pandemic has switched to an endemic, but it continues to impact interaction with buildings. Less in-person work and more remote work are influencing building design. Demographic trends are also changing the construction landscape as people move out of the cities and into suburban and rural areas. This migration largely impacts the types of buildings constructed and the strategies employed to construct them. It is clear that unlocking efficiency and productivity will rely, in part, on the adoption of innovative technologies. The construction industry must continue to find ways to do more with less to unlock the potential upside of Q3.