BURNS & McDONNELL

CONSTRUCTION MARKET UPDATE

Q4 2023

As we approach the close of 2023, it's hard to describe just what kind of year we've had.

Inflation was on the minds of everyone when the year started out. Through the last two quarters, inflation has moderated, but now **the industry is dealing with higher interest rates** that in turn are increasing the cost of financing.

As a result, owners are in a position to consider pushing out big capital projects until the high cost of financing returns to normal … or whatever the new normal is. This may form part of the reason **nearly half of respondents in the ACEC Engineering Business Sentiment survey have a pessimistic view of the economy** going into the new year.

THREE TAKEAWAYS

1. COST AND AVAILABILITY OF FINANCING IS A CONCERN FOR OWNERS.
2. WITH THE VOLUME OF LARGE PROJECTS UNDERWAY, LABOR AVAILABILITY IS TIGHT, AND WAGES ARE ON THE RISE.
3. A COMBINATION OF FACTORS INFREQUENTLY SEEN IN OUR INDUSTRY ALL AT ONCE IS LEADING TO UNCERTAINTY IN 2024.

Meanwhile, **a national onshoring and infrastructure push** is helping propel large projects, which are soaking up available labor resources and driving up wages. Heath Catt looks at what that means for owners on the last page of this quarter's update.

It's a combination of factors infrequently seen in our industry all at once.

If you're like me, you're probably wondering just what 2024 is going to look like. Chances are your crystal ball is as good as mine (maybe even better). Heck, even economic forecasters who get paid to forecast seem to get it wrong.

The main theme for 2024 will continue to be uncertainty. But like always, **our construction professionals are here to navigate these challenges with you**. Thanks for reading and stay safe.

BRETT WILLIAMS
PRESIDENT
CONSTRUCTION GROUP

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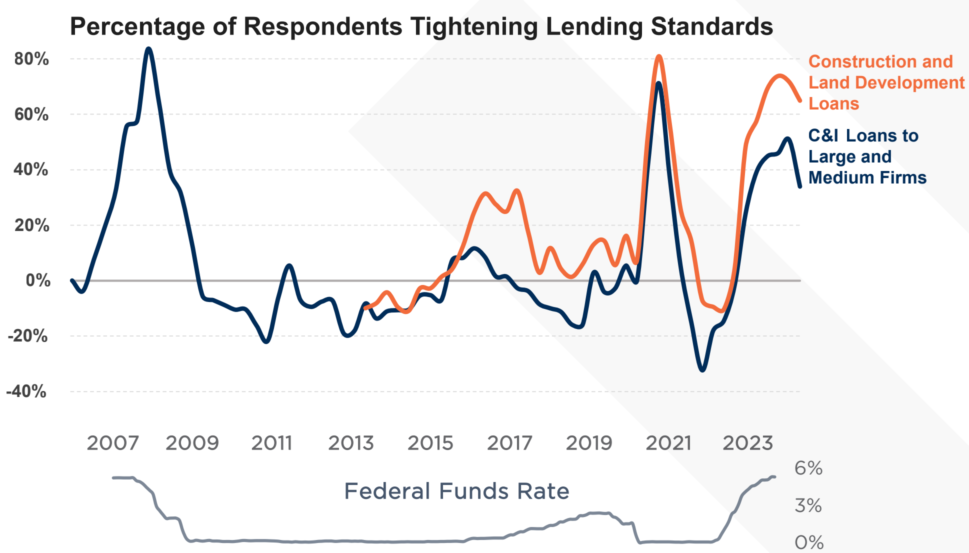
ECONOMIC OUTLOOK

The economy has now grown for five straight quarters as real GDP jumped to a 4.9% annual growth rate in Q3 2023. **The unemployment rate, 3.8% in September 2023, has barely budged for a year and a half.** The consumer price index ticked upward in July and August, largely due to gasoline prices, but inflation continues to trend downward for most categories.

Despite many positive economic indicators, the steep rise in interest rates has led to tighter lending standards and more costly financing for capital projects.

The Federal Reserve publishes a quarterly survey of senior loan officers. For Q3 2023, **33.9% of bank respondents reported tightening standards for commercial and industrial loans (C&I) to medium and large firms**. Outside of a spike during the pandemic, this is the highest rate since 2008-2009. Also, 64.9% of loan officers reported tightening standards for commercial construction and land development loans.



INDUSTRY OUTLOOK

In Q4's [ACEC Engineering Business Sentiment Study,] firms reported strongly positive views of their own finances and the industry overall, especially large firms. **All firms with more than 500 employees rated their own finances positively and over 90% expect to be hiring over the next 12 months.**

Views of the economy going forward have grown more pessimistic, with 40% of firms saying conditions will worsen over the next 12 months, compared to 24% saying they will improve. **Inflation remains the top concern for the near future, followed by political uncertainty and interest rates.**

Both Dodge and ConstructConnect are predicting slight growth in nonresidential starts in 2024. While still above pre-pandemic levels, **manufacturing starts have been declining since 2022's blockbuster year**. Meanwhile, growth has been coming from — and is expected to continue in — infrastructure sectors (streets, bridges, water, sewer and power).

SUPPLY CHAIN

Cost for inputs to nonresidential construction have decreased slightly in 2023 but are still more than 40% higher than in January 2019. Concrete and electric components are the holdouts that continue to trend upward. Since October 2022, total nonresidential construction spending (adjusted for inflation) is up nearly 15%, though still 9.5% below the pre-pandemic peak.

CONSTRUCTION LABOR

According to ConstructConnect, construction began on 20 projects valued at $1 billion or more in the first half of 2023, **including six factories, three power projects and two oil and gas projects**. This is in addition to the 31 billion-dollar projects started in 2022. Regions with high concentrations of these projects (semiconductors in Arizona and Texas; and batteries and electric vehicles in Tennessee, Georgia and the Carolinas as well as Michigan, Indiana and Ohio) could see strong competition for construction labor.

According to the Bureau of Labor Statistics Quarterly Census of Employment and Wages (QCEW), from Q1 2022 to Q1 2023:

- Average weekly wages for private, nonresidential construction companies increased 9.6%, compared to 6.4% for all private-sector employers.
- 34 states saw nonresidential construction wages increase more than 10%.
- Of the 26 nonresidential construction sub-sectors, 24 saw wage increases of at least 7%.

The Associated General Contractors of America (AGC) recently released its 2023 Annual Workforce Survey. Key findings from the survey are:

- Of firms with open positions, **86% reported having difficulty hiring salaried employees and 88% reported difficulty hiring craft labor**. 69% of firms are expecting to add employees in the next year.
- Labor shortages are causing delays on projects (61% of firms) and adding to delays caused by long lead times (65%).
- Firms are increasing wages (82% of firms) and incentives (47%), but many applicants don't have the required skills (74%). In response, they are investing in training, with **60% of large firms increasing spending on training**.

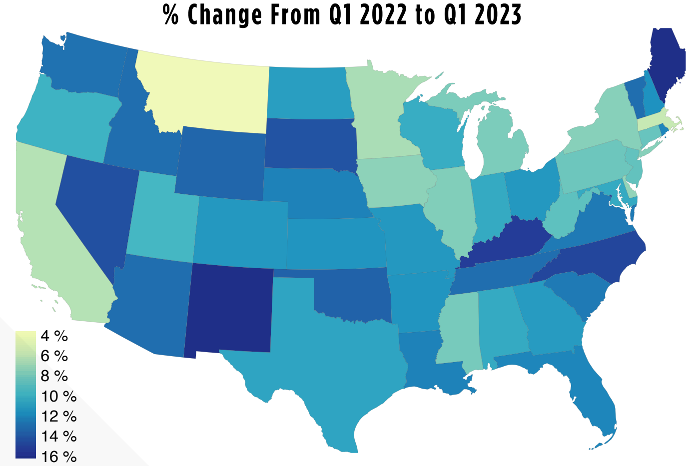
Top Private, Nonresidential Construction Sectors

Construction Subsector	Employment March 2023 (1,000s)	Employment Change From March 2022	Average Weekly Wages, Change From Q1 2022 to Q1 2023
Commercial and institutional building	700	5.7%	**9.7%**
Nonresidential electrical	682	4.2%	**10.1%**
Nonresidential plumbing and HVAC	579	3.4%	**10.1%**
Highway, street and bridge	317	3.2%	**8.8%**
Power and communication line	236	3.7%	**7.5%**
Nonresidential site preparation	232	2.8%	**11.3%**
Water and sewer line	194	3.5%	**10.1%**
All other nonresidential	176	3.7%	**11.8%**
Industrial building	149	3.5%	**7.4%**
Other nonresidential equipment	136	2.5%	**7.1%**
Total Nonresidential	**4,451**	**3.8%**	**9.6%**

Data is for companies within these sectors, not by occupation.

Other compensation measures were in the 4.6%-6.5% range for construction over the same time frame. This data includes bonuses and other non-wage cash payments.

Nonresidential Construction Companies, Average Weekly Wages % Change From Q1 2022 to Q1 2023



Source: U.S. Bureau of Labor Statistics QCEW

PROGRESSIVE DESIGN-BUILD CAN HELP OWNERS MITIGATE COSTS AND MINIMIZE RISKS

COMPETITION FOR SKILLED WORKERS IS CHANGING TRADITIONAL PROJECT DELIVERY

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Spurred by federal incentives, **a wave of large projects is creating challenges for execution**. Timely execution is not only hindered by long lead times for generators and electrical switchgear availability but also by a shortage of those who can actually get the job done. The CHIPS Act, for instance, prompted increased spending in manufacturing — by billions — while the demand for skilled labor, which is already in short supply, makes it challenging to meet both budgets and schedules. This competition for experienced labor has a domino effect, **significantly impacting smaller firms and projects**, whose opportunity to remain competitive in their markets relies on predictable cost and availability of local craft labor.

With such demand for their time and talent, the skilled workforce — from project managers to trade partners and their craft workers — can be more selective on which projects they choose to pursue, and it's changing the look of contract terms and job sites.

Some considerations for attracting skilled labor include:

- Increased wages
- Retention/completion bonuses
- Increased per diem rates
- Travel home/leave considerations
- Improved on-site experience for craft, including conditioned break areas and restrooms

Significant investment in the building trades will continue to be a requirement for the supply-demand pendulum to return to a sustainable balance, and that includes a heavy focus on early-career development. Until the industry can solve the riddle of how to attract more qualified, skilled labor to meet high demand and implement new technologies to supplement the workforce, **owners must pivot quickly from traditional execution methods to achieve their business goals**.