

24th Weekly Crisis-era Message to Contractors from: Dr Tom Schleifer
Construction Market Developments

During the two weeks of answers to readers' questions there were developments that impact the subjects we have been discussing causing an interruption of the Q&A. Media and construction industry reports are beginning to verify concerns about the length and depth of the construction market recovery. In earlier messages we reviewed what it takes to produce a healthy construction market: The need for something to be built and the willingness and ability to fund it. A combination of unemployment and business news indicates certain worsening economic conditions that will affect both the needs for and funding of construction projects in the short and long-term future.

The need for new hotels, movie theaters or amusement parks may take years to revive. The need for airport expansion, office space, shopping malls and cruise ship terminals will not be needed for some time with the potential that the need may be permanently altered. There is no telling what will happen with sports venues, public transportation and convention facilities in the near and long-term future. The list goes on, but you get the point. Fortunately, people will always need a place to live and we need roads, utilities, energy, etc. There is a perpetual need for construction, but it has to be funded. Federal work can continue because they can print money but states and municipalities that have and continue to suffer tax reductions cannot. The Fed may step in but not to the extent that will satisfy the construction industry appetite. As discussed in earlier messages having "some" construction work to do does not work for our industry because we prosper only during a growing construction market. When the market declines even a little, aggressive competition for the lesser amount of work drives profits down, and if there is a lot less work, it can drive profits out. We will never need to prepare for a zero market, but a 90% or 80% market is destructive.

There is no doubt that there will be less work this year than there was in 2019 but much of that backlog was priced during good times and fortunately should be profitable (less any costs associated with new safety protocols). The larger issue is that some areas of the economy are doing OK while other areas are slow or have not begun to recover which will extend the construction market downturn. It is becoming clear that the construction market decline will likely extend through 2021. Therefore, anyone intent on maintaining their size will have to compete aggressively for the lesser amount of work which means drop their prices and participate in driving down industry-wide profits. It would be a little less destructive if other construction firms would voluntarily give up a quantity of their market share so those intent on maintaining size can accomplish that, but unlikely.

The construction market is following the model developed from prior cycles so what has changed? Nothing. The media has caught up to the reality that the recession has momentum and most construction professionals can now see it coming. Some are just not sure what "it" is but all seem to agree that it is not good. "It" will be an industry-wide construction market downturn similar to the 2009-2012 market that most of us can remember. Additional details will unfold as the economy and construction market progress.

A review of the announcements of some of the latest economic and construction market developments will demonstrate why the Q&A was interrupted for this construction market update:

~The Labor Department reports long-term unemployment, for 15 to 26 weeks, rose by 4.6 million, the highest since 1948. University of Chicago researchers estimate 32% to 42% of American job losses during

the pandemic will be permanent. Cornell University survey discovered that 31% of recalled workers had been laid off again.

~8/17/20 WSJ: ...unemployment claims data suggests many businesses continue to shed jobs and ...the economy probably has not reached the point where it can enter a sustainable recovery without additional support...

~8/8/20 WSJ: The degree to which schools are able to open matters (to the economy). There are upwards of 24 million working parents with children under 18, and most in jobs that can't be done from home.

~WSJ 8/9/20: Without more money from the federal government, states and local governments will almost certainly have to cut their budgets and lay off workers, increasing the ranks of the unemployed.

~WSJ 8/12/20: Corporate purchases of air travel down 97% and only 10 % of companies surveyed will allow international travel within next three months. Some business travel may be lost forever, and corporate flyers make up 15% of passengers but 40% of revenue and on some flights and as much as 75% of the profit.

~Various studies predict between 6% to 8.5% GDP decline in 2020 barring another wave of virus. Federal infrastructure spending continues to be uncertain. Caterpillar 31% drop in sales. Komatsu 25% decrease globally. Boeing--no jetliner demand for at least three years. Municipalities warn of layoffs due to falling tax revenue. Half the 22 million jobs lost not replaced yet. Bank of England does not expect their economic recovery until 2022.

There is no room for denial. A nation-wide vaccine tomorrow will not bring the construction market back soon enough to avoid the required reduction in the the cost of doing business essential to getting through this. Cooperate with the market decline by cutting overhead in an effort to profit during it or fight the market decline in an effort to capture a greater share of a less work. The risk differential is too great.

Next week: **Continued response to questions and comments from readers. Send questions/comments to tom@schleifer.com.**

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Note: Information on overhead management can be found on letstalkbusiness.net click on "Manual", then Managing Overhead in the table of contents.