WHITEPAPER

State of the Construction Industry: 2022

Executive summary

The construction industry has experienced healthy growth in the five years to 2021, despite the impact of the COVID-19 pandemic. Although the pandemic-related economic downturn in 2020 caused construction revenue to drop 0.5%, industry revenue still grew at an annualized rate of 2.4% during that period, bringing total industry revenue to $2.4 trillion.[1]

Construction firms are expected to continue performing well in the five years to 2026. The steady growth of the residential housing market and the recovery of nonresidential construction will fuel industry growth during the coming five-year period. Revenue is expected to grow at a rate of 2.0%, bringing total revenue to $2.7 trillion.[2]

The construction industry today

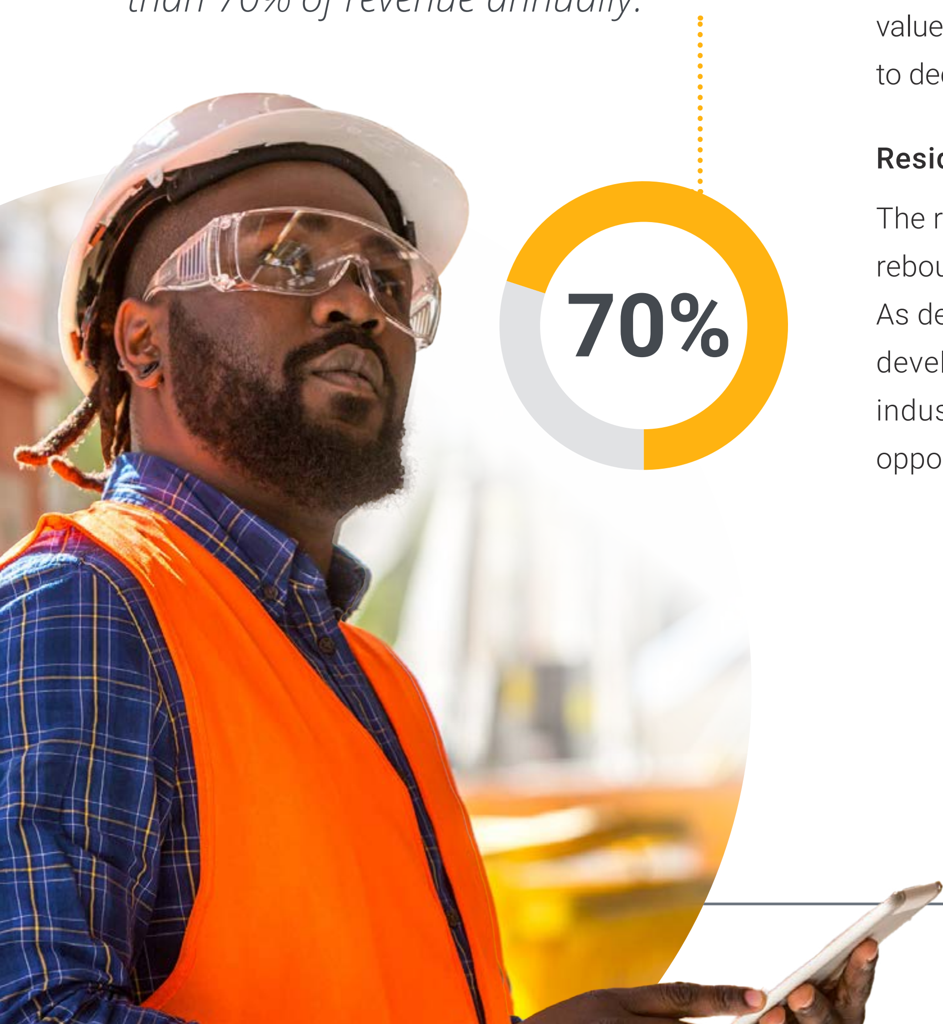
The construction industry had a strong growth rate in the five years to 2021, experiencing an annualized growth rate of 2.4% over that period, bringing total revenue to $2.4 trillion.[3] Although the industry suffered as a result of the pandemic (industry revenue declined by 0.5% in 2020), a strong 2021 helped stabilize growth.[4]

These are four of the key external factors that drive growth in the construction industry:

Corporate profit:

Corporate profit is one of the key drivers of growth in the industry. As profit margins increase, companies have more resources to devote to construction projects. Higher profits are also generally a sign that companies are growing, signaling a need for bigger — and more attractive — office spaces. Corporate profit took a hit in 2020, but it's expected to skyrocket in 2021 as businesses continue to reopen.

The nonresidential property market is a main driver of construction revenue growth, accounting for more than 70% of revenue annually.



Government investment:

Construction companies derive a substantial portion of their revenue from government projects. Although government investment was initially expected to decline in 2021, the recent passage of the $1.2 trillion infrastructure bill will inject an enormous amount of capital into a number of construction industries. The bill is also expected to add around 2 million jobs to the economy, mostly in the construction industry.[5]

Nonresidential property value:

The nonresidential property market is a main driver of construction revenue growth, accounting for more than 70% of revenue annually. Due in part to the lingering effects of the COVID-19 pandemic, the value of nonresidential construction was expected to decline further in 2021 after a drop in 2020.

Residential construction:

The residential housing market is expected to rebound in 2021 after a difficult year in 2020. As demand for new houses, renovations and developments increases, the construction industry is projected to experience a major opportunity for growth.

Projections for the construction industry

Due to the nature of the construction industry, construction revenue is closely tied to revenue in other industries. Construction companies were badly impacted by the effects of the COVID-19 pandemic in 2020. There was less investment available for new construction projects, drying up much of the resources needed to fuel industry growth.

However, the high performance of the residential housing market and the reopening of commercial properties is expected to drive growth in the industry over the next five years. Revenue is expected to grow at a faster rate in that period than it did in the previous five.

This rate of growth is expected to be driven partly by increased residential construction activity, projected to account for 27.2% of industry revenue in 2021.[6] The value of residential construction is expected to grow at a rate of 0.6% in the five years to 2026. Much of this growth will be due to the sector rebounding from the effects of the COVID-19 pandemic.

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Rising cost of building materials

It is not all good news for the industry. The cost of building materials is expected to continue rising, putting added strain on construction firms and creating an increasingly large expense. In the 12 months prior to August 2021 alone, prices increased 19.4% in the 12 months, according to the U.S. Bureau of Labor Statistics.[8]

The rising cost of building materials is fuelled in part by the supply chain disruptions caused by the pandemic. Although supply routes are expected to stabilize in the five years to 2026, the industry will still face the effects of that disruption in the early part of that period.

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Labor shortages

Compounding the problem, the severe labor shortage facing the United States is expected to have both a direct and indirect effect on the industry. The Home Builders Institute found that the industry is facing a shortage of 2.2 million workers, making it extremely difficult for firms to meet the rising demand.[9]

These shortages are hurting the construction labor supply, but they are also driving up the cost of doing business with suppliers in other industries, making it more difficult — and costly — for firms to procure the building materials they need to complete projects.

Therefore, despite the projected increase in revenue for the industry in the five years to 2026, the rising cost of building materials and the associated labor shortages will act as a check on the growth of the construction industry. As a result of these market forces, profit margins are expected to remain mostly unchanged, leveling out at an annualized rate of 5.9% to 2026.[10]

Changes/risks facing the construction industry

Technological change

The core methods, tools and processes used by construction professionals have changed little over the previous few decades. Firms in many construction industries, including bricklaying, roofing, carpentry, tiling and landscaping, do not usually require heavy machinery or advanced tech to complete projects.

Still, larger firms with more complex portfolios have begun to develop more sophisticated methods for completing projects. In particular, the emergence of more advanced design, management and automated methods have helped streamline certain manual tasks and enabled those firms with the capacity to deploy software-based tools to gain a significant competitive advantage.

Greener building materials

The public's growing concern over climate change is beginning to have a measurable effect on the construction industry. Some builders have started exploring more sustainable building methods, and building owners and occupants are increasingly requesting buildings fixed with safer, healthier and more sustainable building materials.

Despite these changes, there still has not been an industry-wide shift to new materials for environmental purposes, with those making that transition limited to a narrow section of the industry. While those trends are likely to increase in the coming years, they have not yet caused a fundamental shift in building practices.

Environmental regulations

As the industry gradually moves toward new building materials, pressures from municipal and state bodies could begin to have an impact from an external standpoint. The global construction industry is responsible for emitting 14 gigatons of carbon into the atmosphere every year, according to the World Business Council for Sustainable Development.[11]

Some state and local authorities have introduced new environmental regulations aimed at curbing those emissions. Similar to the sustainable material trend, these regulations are generally localized and have not had a demonstrable impact on the industry as a whole. However, as governments and the public grow increasingly concerned about climate change, it appears likely these regulations will become tighter in the coming years.

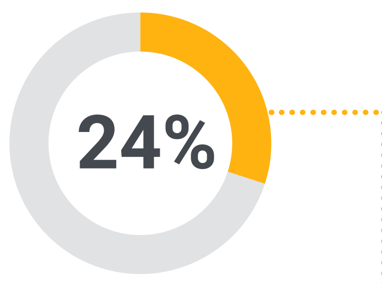
Immigration

The construction industry could be heavily impacted by immigration legislation. In 2019, immigrant workers occupied 2.8 million construction jobs, accounting for 24% of the total industry workforce, according to the American Community Survey.[12] State and national legislation that limits the flow of immigrant labor to the country — whether directly or indirectly — could put pressure on construction firms that depend on foreign-born labor.

Private equity

Private equity was not traditionally a reliable source of capital in the construction industry, and few firms were able to secure private investment. However, as the construction industry continues to boom and some companies have established themselves as lucrative sources of wealth for investors, private equity has emerged in recent years as a serious consideration for construction companies.

To attract private equity funding and stay competitive in a crowded market, construction firms will have to demonstrate regulatory compliance, long-term growth strategies, management competence and reliable sources of revenue.



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Minimum wage

Pressure is mounting on local, state and national authorities to raise the minimum wage to $15/hour. Most skilled professions in the construction industry make well above $15/hour, meaning a wage increase is unlikely to touch most of the industry. In fact, data from the U.S. Bureau of Labor Statistics show that no construction job had a national average of less than $15/hour.[13]

However, smaller firms operating in states with lower average wages are far more likely to pay staff below minimum wage. In the event of a wage hike, those companies could be forced to make difficult decisions about certain staff and/or business practices.

Population shifts

Populations are on the move, and that means some housing markets are experiencing substantial construction booms, representing major growth opportunities for the industry.

Here are the top 5 fastest growing state housing markets, according to Bankrate:[14]

Utah.

New Hampshire.

Washington.

Arizona.

Montana.

Conclusion

The construction industry is set to undergo significant change in the coming five years, creating new challenges but also presenting growth opportunities for construction professionals. As the industry begins to stabilize in the wake of the COVID-19 pandemic, it's important for construction companies to properly assess the risks associated with other changes in the industry so they can stay ahead of that change.

Confronting those changes requires partnering with the right insurance providers and experts to successfully navigate associated risks and ensure future growth.

Reach out to our team at **nipgroup.com** to get started.

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