CALL IT A COMEBACK:
Positioning for the Post-COVID Boom

September 2021

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In March 2021, when the container ship the *Ever Given* snagged its bow on the shoreline of the Suez Canal, the U.S. construction market was already under pressure from demand for new builds and delays in the global supply chain. A historic housing boom was underway, but the stuck ship illustrated the potential for things to careen sideways.

Though the onset of pandemic-related shutdowns in the second quarter of 2020 sent the U.S. economy into a sharp contraction, the residential construction sector has gone from strength to strength in the quarters since. Low housing inventory and optimistic builder sentiment[1] fomented a boom that pushed up home sale prices by double digits[2] and created a lumber bubble.[3] The chair of the National Association of Home Builders (NAHB), Chuck Fowke, has said he expects demand to remain high for the next 15 years, but the market has begun to respond to fears of a rebound. In July the NAHB/Wells Fargo Market Index edged one point lower,[4] still in "very optimistic territory." Lumber prices also saw a correction.

Firms looking to position themselves for the post-COVID construction economy need to pay close attention to emerging market data to make informed decisions. There is growth in all key indices FMI uses to track activity, with some reaching historic highs:

- The three-month moving average for the Chicago Fed National Activity Index, a gauge of activity across industries, rose to +0.28 in July from +0.01 in June.[5]
- FMI's proprietary nonresidential construction index (NRCI) was 59.7 in the third quarter of 2021 and has been showing strong momentum since the fourth quarter of 2020, well within expansionary territory.[6]
- The forward-looking Construction Industry Round Table (CIRT) Sentiment Index[7] reached a new record high of 79.7 in the third quarter of 2021, with the design index surpassing the early 2018 record high of 85.4 to hit 86.8.

Looking to the next quarter, **70% of CIRT respondents expect moderate or significant growth in the nonresidential construction market**, and 64% expect growth in their key economies. Most respondents forecast growth in transportation and manufacturing.

1 NAHB/Wells Fargo Housing Market Index (HMI). National Association of Home Builders. Apr. 15, 2021.

2 Monthly New Residential Sales. U.S. Census Bureau. August 2021.

3 Lambert, L. "Biden Administration Could Double Canadian Lumber Tariffs Even As Wood And Construction Costs Soar." *Fortune*. May 29, 2021.

4 "Builder Confidence Edges Lower as Material Challenges Persist." National Association of Home Builders. Jul. 19, 2021.

5 Chicago Fed National Activity Index (CFNAI). Federal Reserve Bank of Chicago. Aug. 23, 2021.

6 "2021 North American Engineering and Construction Outlook." FMI Corp. Q3 2021.

7 "CIRT Sentiment Index: 2021 Second Quarter Report." FMI in partnership with CIRT. Q2 2021.

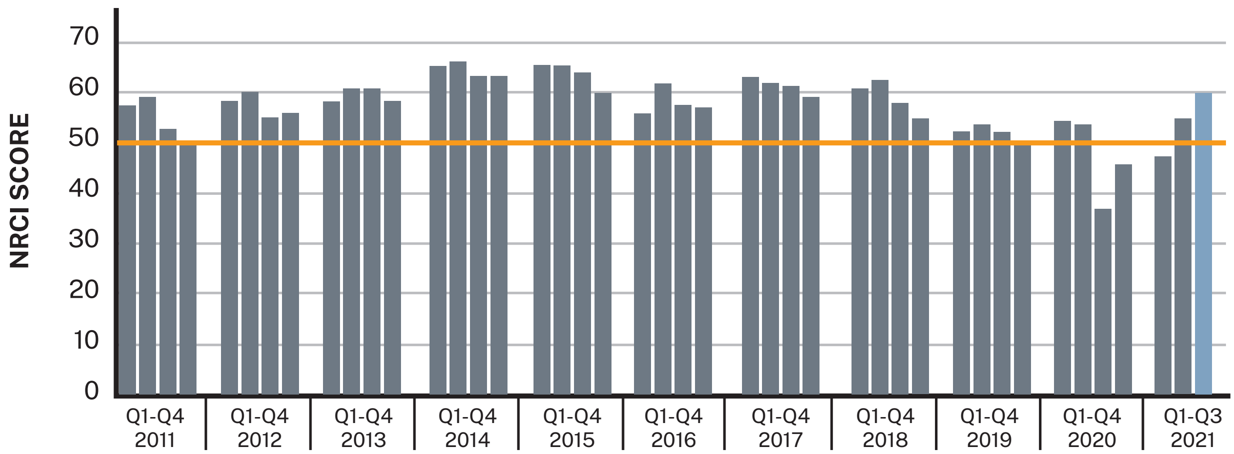
FIGURE 1.

POSITIVE SENTIMENT INCREASING IN 2021

Nonresidential Construction Index (NRCI) Q1 2011 to Q3 2021

NRCI scores are based on a diffusion index where scores above 50 indicate improving or expanding industry conditions; a score of 50 represents conditions remaining the same; and a score below 50 signals worse conditions than last quarter (or contraction).

Current NRCI Reading for Q3 2021 (June 8 - June 18)	59.7
Previous Reading	54.4



Source: FMI, Q3 2021[8]

The U.S. is now at or above the 25-year average for growth in construction, following a 76% increase in construction spending from 2010 to 2020.[9, 10] The limiting factor is supply. Shortages in (and high costs of) construction materials and labor have hobbled growth. The supply of critical construction inputs such as copper and steel remain constrained, and supply chain fragility has led to limited availability and delays for items like steel bar joists and specialty fittings.

8 The data in the NRCI is presented as a sampling of construction industry executives voluntarily serving as panelists for this FMI survey. Responses are based on their experience and opinions, and the analysis is based on FMI's interpretation of the aggregated results.

9 Strong growth in 2020 was primarily due to the residential sector while nonresidential building spending declined.

10 U.S. Census Bureau. "Total Construction Spending: Total Construction in the United States." Retrieved from FRED, Federal Reserve Bank of St. Louis; Sept. 7, 2021.

A MIXED PICTURE: THE RECOVERY WILL VARY BY SECTOR AND GEOGRAPHY

This is a historic recovery and signals a shift in long-term trends, as we discuss in the next section. To capitalize on pent-up demand and public funding, you will have to orient your firm to the sectors and regions poised for sustained growth. We know from the early stages of the last prolonged expansion beginning in 2011 that contractors who reevaluated their services, clients and markets were able to build their pipelines in the new market environment. We forecast most industry segments to expand over the next five years. Standout sectors include:

- **Manufacturing:** As domestic demand climbs and recognition of critical supply chain challenges leads to manufacturers looking for domestic partners or onshoring.
- **Highway and street, transportation and water/wastewater:** Amid a massive government stimulus supporting infrastructure spending.
- **Health care:** Driven by an aging population and increasing geographic footprint.
- **Education:** As aging and insufficient facilities are repaired and expanded.
- **Conservation and development:** As climate change impacts coastal infrastructure and water supply.

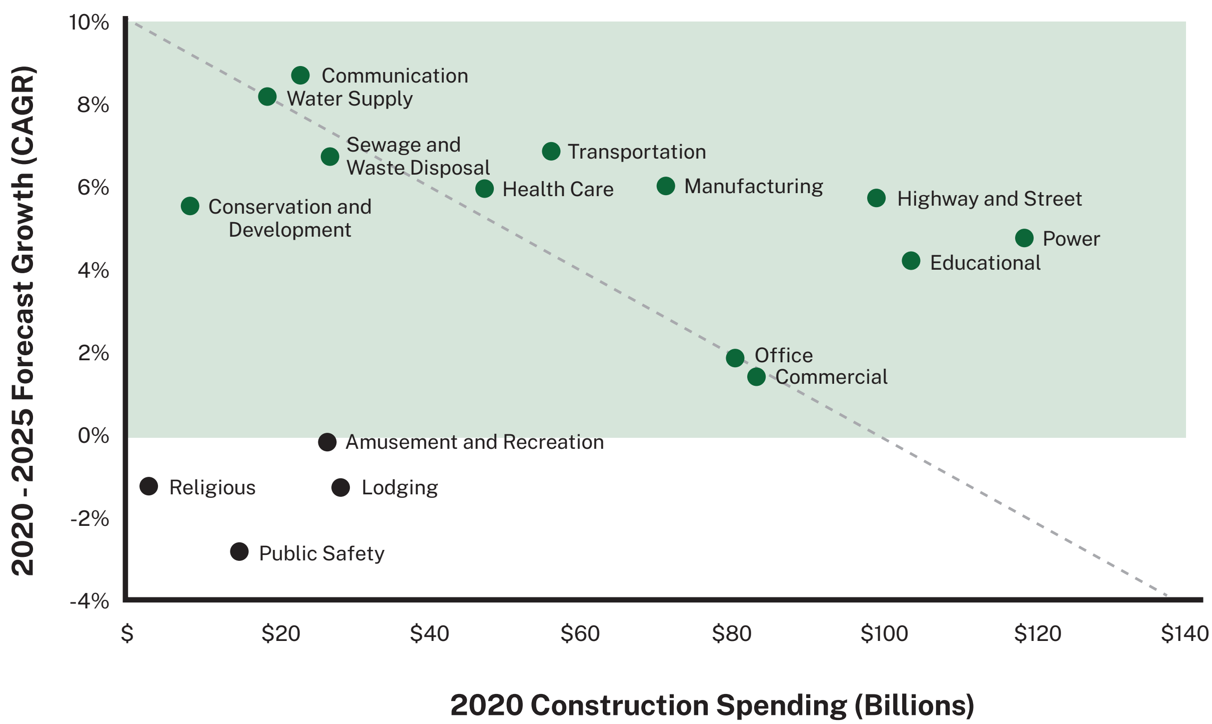
FIGURE 2.

BULLS AND BEARS AMONG CONSTRUCTION SECTORS

US Market Outlook

More Bulls Than Bears Over the Next Five Years

Construction Spending Put in Place (US) Billions of Current Dollars



Source: FMI Q3 2021 forecast

Current data shows that $1 in $3 spent on construction go to one of 12 geographic hotspots, traditionally large magnet cities or key interstate corridors. Drilling down, opportunities continue to grow in areas with outsized population growth in what has been called the reshuffling of the American workforce.[11] Zillow's market research has found that for expensive metro areas, home prices reflect demand for homes further away from job centers, while in smaller metro areas, prices are rising for houses offering a short commute to the central business district.[12]

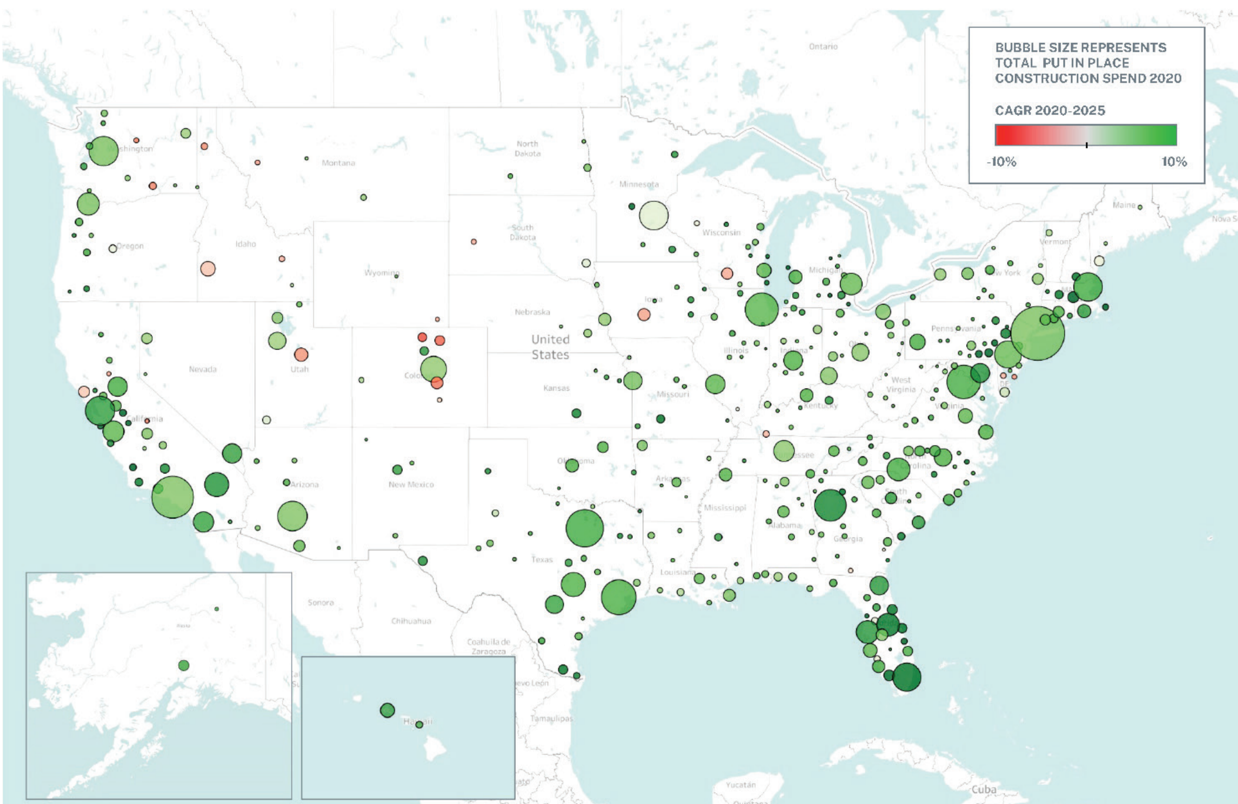
11 "Permits by Metropolitan Area." U.S. Census Bureau. May 2021.

12 "The Great Reshuffling Is Changing How Far Americans Are Willing to Commute." Zillow. Jul. 21, 2021.

The $1 trillion infrastructure bill passed by the Senate in July 2021 will reach large metropolitan centers and rural communities alike, with new funding being allocated to roads and bridges ($110 billion), passenger and freight rail ($66 billion), broadband ($65 billion), electric and power infrastructure ($73 billion), and environmental remediation ($21 billion). While there will be a lot of competition bidding on these projects, contractors who understand the dynamics of their regional markets will be poised to capture work.[13]

FIGURE 3.
GEOGRAPHIC HOTSPOTS

Total Construction Spending Put in Place 2020 and Forecast Growth (2020 through 2025) by Metropolitan Statistical Area



Source: FMI Q3 2021 forecast

13 "The Senate Approves $1 Trillion Bipartisan Infrastructure Bill in a Historic Vote." NPR. Aug. 10, 2021.

THE TRILLION-DOLLAR QUESTION: WHAT DOES THE FUTURE HOLD?

While key market fundamentals remain true, the effects of the pandemic have catalyzed changes long in the works. As companies plan for five and 10 years down the road, there are costs and opportunities to many of the strategic choices related to where and how to invest in the future. The clearer picture you have of the current moment, the more agile you can be.

To get a comprehensive view of the near term, we worked with CIRT members to look at the kinds of changes we believe are temporary and pandemic-related, and those that will be permanent.

Long-term shifts present a huge opportunity for firms capable of catering to that sector and region. Four standout, longer-term trends illustrate the scale of the shift taking place.

1. The Growth of Retail Medical Facilities

The urgent care sector has seen 9% year-over-year growth, according to the Urgent Care Association, with more than 10,000 centers nationwide (not including those in grocery stores or pharmacies). Sector growth appears even more dynamic when you look at the expansion in retail medical.

The COVID-19 pandemic revealed the gaps in health care infrastructure and highlighted the role that retail can play in community health. There are nearly two dozen retail pharmacies, including Walmart Inc., CVS, Walgreens, Kroger and Rite Aid Corp, working with the federal government to provide COVID vaccines.[14]

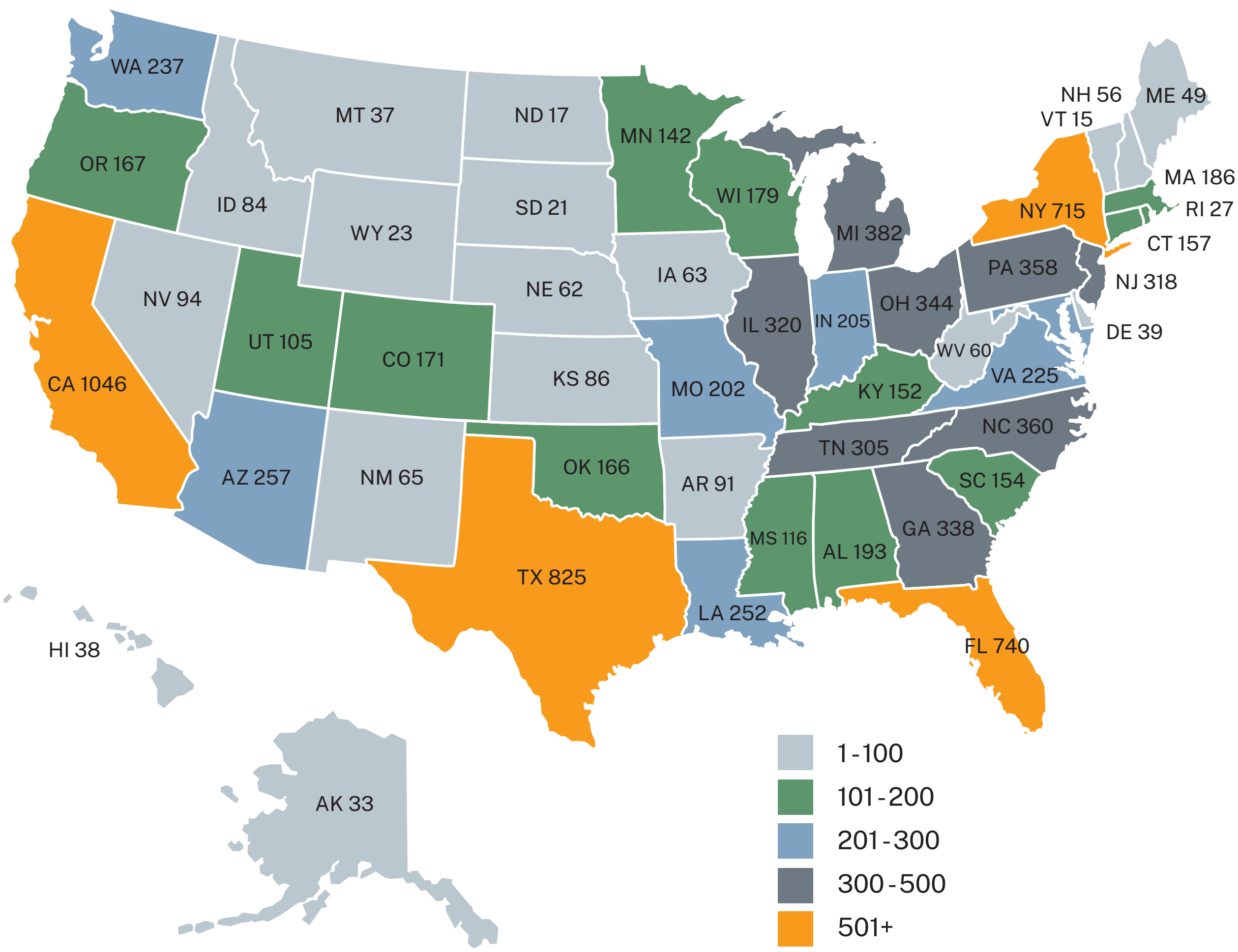
14 "CVS, Walgreens Look for Sales Bump from COVID-19 Boosters." The Wall Street Journal. Aug. 19, 2021.

The indispensability of in-store and stand-alone retail medical clinics points to a shift in consumer behavior: You can find a Walmart within 10 miles of 90% of the U.S. population, and demand is not saturated.[15] Walmart has now opened a handful of stand-alone health centers in Georgia, Illinois and Arkansas, offering primary care, dental, diagnostic and behavioral services, with plans to expand into Florida and other markets.

Shortfalls in the stressed U.S. health care system suggest that there could be a long-term shift toward provision of medical services at local pharmacies and retail health care hubs.

FIGURE 4.

URGENT CARE CENTERS INCREASE ACROSS NATION



Source: UCA

15 “Our Mission to Bring Affordable Care with Walmart Health.” Walmart. June 17, 2020.

2. The Accessibility of Remote Education

The pandemic demonstrated the costs of remote schooling for young children, with the Centers for Disease Control (CDC) noting the importance of on-site learning to avoid worsening inequities late in the 2020-2021 school year.[16] Over the past year, demands on class space and a growing learning gap underscored the need for improved facilities in K-12 schools.[17] More than half of public school districts need to update or replace multiple building systems, including HVAC systems, and more than a third are using portable buildings due to a lack of capacity within existing facilities.[18]

In the higher education sector, it is a different story. Given the sky-high cost of tertiary education and the burden of student loan debt, many students deferred or decided not to enroll during a year of remote learning. Community colleges saw a 9.5% drop in enrollment for spring 2021 from the previous year, while the overall sector saw a 3.5% drop.[19] Mature/older students in particular found greater economy and flexibility in remote learning, allowing them to balance family and work around education.

Will there be a move toward affordable online tertiary education? Enrollment for the 2021-2022 year will help inform demand fundamentals for college construction going forward.

3. The Decentralization of the American Worker

The pandemic undoubtedly disrupted office culture, prompting a year of ad hoc remote work, sometimes successfully, and sometimes less so. Just 13% of American workers say they want to return to working full time on-site after the pandemic, and 87% want to work from home at least one day a week, according to a survey by Morning Consult for Prudential.[20] However, coverage of this shift has often focused on white-collar work. An analysis of BLS data published in the *American Journal of Public Health* found **only 25% of jobs can be performed remotely**. This bifurcation will drive the office sector in the years ahead.

The viability of remote work and lower costs of living outside key metropolitan areas will create demand for new or upgraded satellite workspaces in fast-growing areas. A survey of 1,000 American workers by The Brand Guild found that 50% had considered moving to a new area during the pandemic, while 82% preferred suburbs to cities.[21]

In city centers, the inevitable reopening will mean retrofitting of health and safety features, like automatic entry and touchless door hardware, and reconfiguration of offices to separate employee areas from client meeting spaces. The remote work revolution might provide employees with greater flexibility and the potential for hybrid work schedules. Still, a model where employees work three days on-site, and therefore overlap on certain days, would require as much office space as a model under which all employees are on-site full-time. We expect office-sector demand to remain strong.

16 "Operational Strategy for K-12 Schools through Phased Prevention." CDC. May 15, 2021.

17 "The Importance of School Facilities in Improving Student Outcomes." American Journal of Evaluation. Jun 7, 2015.

18 "ASCE's 2021 Infrastructure Report Card: Schools." American Society of Civil Engineers. 2021.

19 "Spring 2021: Current Term Enrollment Estimates." National Student Clearinghouse. June 2021.

20 "Pulse of the American Worker Survey: Is This Working?" Prudential Financial Inc. March 2021.

21 "Live. Play. Work. The Great American Shakeup." The Brand Guild. July 2021.

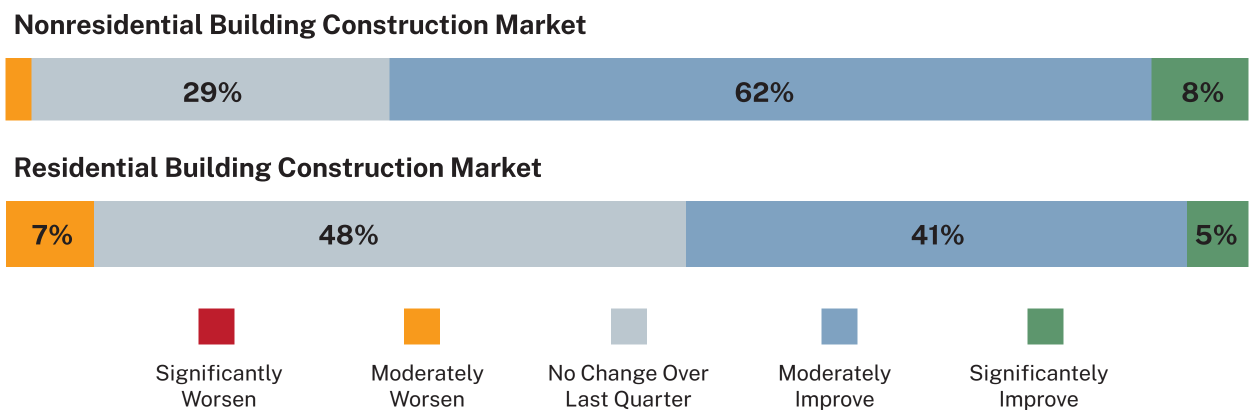
4. The Return of the Suburbs

Supply shortages and residential construction backlogs speak to a huge demographic shift out of city centers to cities with lower populations and to single-family homes in the suburbs for many of the reasons discussed above.

The CoreLogic Single-Family Rent Index saw a 5.3% year-over-year increase in April 2021, up from a 2.4% year-over-year increase in April 2020.[22] This has been driven by a shortage of housing stock and a move away from expensive coastal hubs like San Francisco and Boston to landlocked cities like Phoenix, Tucson, Atlanta and Provo, Utah.

FIGURE 5.

EXPECTATIONS FOR Q4 2021 ARE POSITIVE FOR THE NONRESIDENTIAL MARKET AND STEADY FOR RESIDENTIAL



Source: FMI/CIRT

Residential construction spending climbed 26.5% in July from the previous year, according to the U.S. Census Bureau.[23] Private housing starts climbed 44.3% in July 2021 from June of the previous year.[24]

A majority of CIRT respondents anticipate moderate or significant improvements in market conditions in nonresidential construction in the next quarter, and 46% are optimistic about residential market conditions. The suburbs are back.

22 "Single Family Rent Growth Rate More Than Doubles Year Over Year in April CoreLogic Reports." CoreLogic. June 15, 2021.

23 "Monthly Construction Spending, July 2021." U.S. Census Bureau. September 1, 2021.

24 "Monthly New Residential Construction, July 2021." U.S. Census Bureau. Aug. 18, 2021.

WHAT DOES THIS MEAN FOR YOU?

In just 12 months, long-held assumptions about the inviolability of the corporate office, household savings behaviors, spending on higher education, climate change impacts and the future of health care have been completely upended.

Companies innovated with remote work, small cities saw an influx of new residents, and retailers became a key ally in the COVID-19 offensive. The effects of the pandemic will shake out for years, but the post-pandemic era has already arrived, and contractors need to position themselves for that reality.

Considering your company's key value proposition and specialty areas, you need to view the above trends and ask yourself how they apply to your market position. Specifically, ask yourself:

- **Does the recovery look durable or fragile for my line of work?**
- **Will growth in my sector and region result in expansion or contraction?**
- **Are the headwinds (or tailwinds) for our pipeline temporary or permanent?**

The intel of CIRT respondents offers some clues by industry sector, but we emphasize again that sentiment is solidly optimistic. Once you determine there is a durable recovery taking place in your market segment, the question is how to optimize your bidding in that field. Don't waste time — act now.

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