The Risk of Wage Rises in Construction: Three Key Trends

By Mike Rose

Operating a tightening labor market, engineering and construction firms need to pay close attention to salary, benefits and other labor-related trends that can help them avoid job delays, botched projects and profit losses.

Why do contractors keep guessing about pay? In this "war for talent" in key construction roles, contractors continue to underpay and overpay, based on anecdotal information or small sample bias. In FMI Compensation's Incentive Compensation Effectiveness Study,[1] most contractors receive their pay information from peers. Only a quarter of contractors use labor market intelligence. There are multiple sources of labor market pay rates for the construction industry, but there is probably a lack of awareness of its availability. In this new era of big data and intense labor competition, contractors could benefit from changing their pay practices. Instead of basing pay decisions on what candidates demand, what the recruiter says, or divinely inspired hunches—do your research and look it up!

Pay is moving in unexpected ways in critical skill areas and geographies while moderating in other "cooling" skill areas. Understanding market pay trends allows leaders to plan more accurately for the future and adapt to important developments that are fundamentally reshaping the industry.

In this article, we explore three key trends currently shaping the compensation aspect of the construction market and provide recommendations that firms can use to navigate the market fluctuations and come out ahead.

Labor: A Not So Ancient History

From December 2007 to June 2009, the Great Recession resulted in more than 8.2 million job losses across the nation. Construction put in place fell from a seasonally adjusted annual rate of $1.2 trillion in March 2006 to a low of $754 billion in February

[1] FMI Incentive Compensation Effectiveness Study. The 2013 U.S. Construction Industry Incentive Compensation Survey. 2013.

2011. By the end, approximately 2.3 million construction jobs were lost—nearly 30% of the construction workforce.

Six years later, the construction industry is back on track, albeit characterized by some ebb and flow. In April of this year, a decline (biggest in five years) left total construction spending at a seasonally adjusted annual rate of $1.13 trillion, up 4.5 percent from a year ago.[2]

Total construction employment has rebounded to just over 6.5 million[3] workers, still a far cry from its peak of 8 million workers in 2006. Despite being almost 20% below its 2006 peak, the industry is struggling to find qualified labor. Could 1.5 million workers have left the workforce for good?

The answer is an unequivocal yes. Some workers found new careers, while others left the workforce entirely. In fact, according to research published by the Census Bureau, the authors suggest "60% of displaced construction workers have left the labor market or moved into other industries." The authors also note that, "Although some former construction workers transitioned quickly to other sectors, for most, a move into another industry occurred after a long spell of non-employment."[4]

With baby boomers retiring and a lower number of college and high school graduates entering the construction field, we're seeing a widening gap between construction labor supply and demand for such labor. Consequently, wages are increasing steadily—in some cases dramatically.

Ken Simonson, AGC's chief economist confirmed, "Although construction employment slipped in April and May, the industry has added workers in the past year at double the rate of the overall economy. Average pay in construction is rising faster than in the rest of the private sector, and the number of unemployed construction workers was at the lowest May level in 16 years. These facts support what contractors tell us: they have plenty of work but are struggling to find qualified workers to hire."[5]

Business is brisk and markets are tightening. As these trends continue, the decline in the construction labor force is having an impact in areas where skilled worker shortages are now prevalent. U.S. skilled-worker wages are expected to average 4%-plus growth through 2017,[6] with wage growth in skilled occupations fluctuating based on geography and skill set.

Following are three specific construction wage trends (based on FMI compensation's industry surveys for construction professionals) that companies should be paying attention to in 2016.

Three Key Construction Wage Trends and Projections

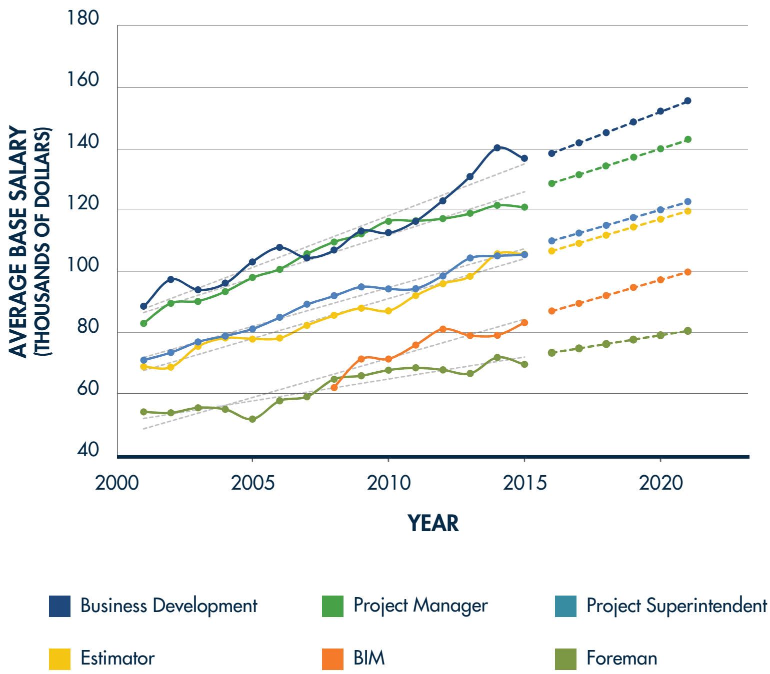
Trend #1: Rising Construction Professional Pay Rates

For the past 15 years, FMI's Compensation Group has been tracking six key benchmark job families, including business development, project management, project superintendent, estimator, general foreman and Building Information Modeling (BIM) professional. Exhibit 1 shows the base pay trend for each job and reveals that, in general, pay

[2] "US Construction Spending Tumbled in April." Martin Crutsinger. Associated Press. June 1, 2016.
[3] Bureau of Labor Statistics. Employment statistics for May 2016.
[4] Here's Where All the Construction Workers Went." Jeffrey Sparshott. WSJ Blog. Oct 19, 2015.
[5] "Construction Headcount Dips in May but Outpaces Overall Rate of Job Gain since May 2015; Rising Pay, Plunging Unemployment Suggest Worker Scarcity." Ken Simonson. June 3, 2016.
[6] "Tightening Labor Market and Rising Construction Wages for 2016." Guest post from IHS. Spend Matters. February 18, 2016.

EXHIBIT 1

CONSTRUCTION PROFESSIONAL PAY TRENDS AND PROJECTIONS



Source: FMI Compensation Survey Data

levels have been increasing since 2001. Although employment levels may have receded during the recession, those jobs requiring specialized skills and knowledge have experienced steady pay increases.

Looking ahead, annual base pay averages for business development and project management, for example, are forecast to exceed $140,000 by 2020. During that same time, base pay averages for project superintendents will exceed $120,000, and pay for general foremen will exceed $80,000. For BIM professionals, average base pay is on track to hit $100,000 by 2020.

Some wages are rising more rapidly than others, including those for business development, for example. This trend indicates that the industry is emphasizing revenue generation in an increasingly competitive environment. This goes beyond nurturing client relationships and extends to researching and gaining a better understanding of owner needs and proactively providing solutions. A more complex sales process requires more highly skilled professionals who, in turn, demand higher compensation. The industry may see the emergence of more traditional sales forces (larger with more specialized roles) not unlike building product manufacturers or mechanical contractors.

As the industry expands and as organizations ramp up their hiring strategies, they must incorporate these increasing labor costs into their human capital strategies and project estimates.

Trend #2: Disparities in Geographic Pockets

Different geographies experience significant differences in pay. Exhibit 2 shows the variation in average pay for project managers. Higher pay is indicated in red and lower pay in blue. The hotter areas include the western coastal cities as well as the New York City metropolitan area. However, hot areas (areas of higher pay) are interspersed throughout the country. Indeed, hot areas can be adjacent to cooler cities, which suggests that local labor market data is critical to understanding competitive pay levels.

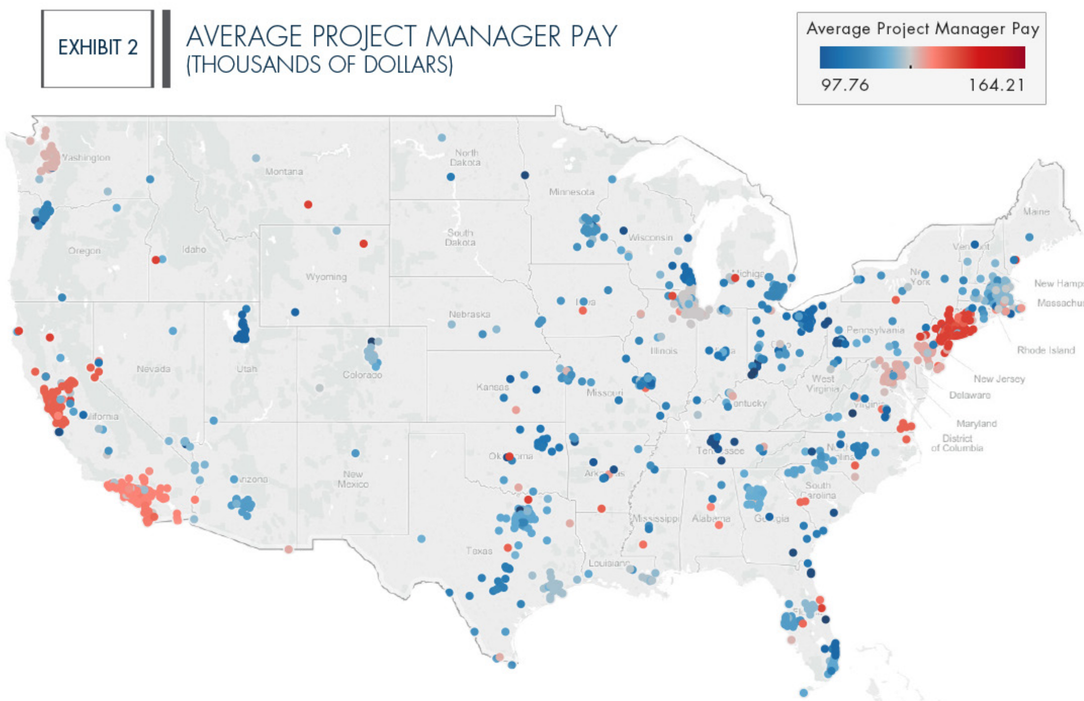
For construction firms, failure to recognize the local labor market conditions can result in either overpaying or losing top talent. For example, average project manager pay in red-hot San Francisco is $142,000, while average pay in nearby Monterey is $101,000. Now, it's true that Monterey is a lovely place to live and the cost of living in San Francisco is high, but with all those red-hot pay areas located just a little north, it's certainly worth considering the move.

Exhibit 3 illustrates the rate of pay increase across the country for project managers. Hot areas (those with maximum pay increase) are indicated in red. Not surprisingly, project manager wages are increasing in high-growth, urban areas. In addition, at some point, the pay differential becomes irresistible. Hence, firms must understand the local market conditions but also the nearby local, state and regional conditions in order to retain key talent.

For business planning purposes, organizations must recognize the overarching trends, or risk falling behind in key competitive areas. In addition, they must understand not only the local market conditions but also the labor market dynamics. Otherwise, orga-

EXHIBIT 2

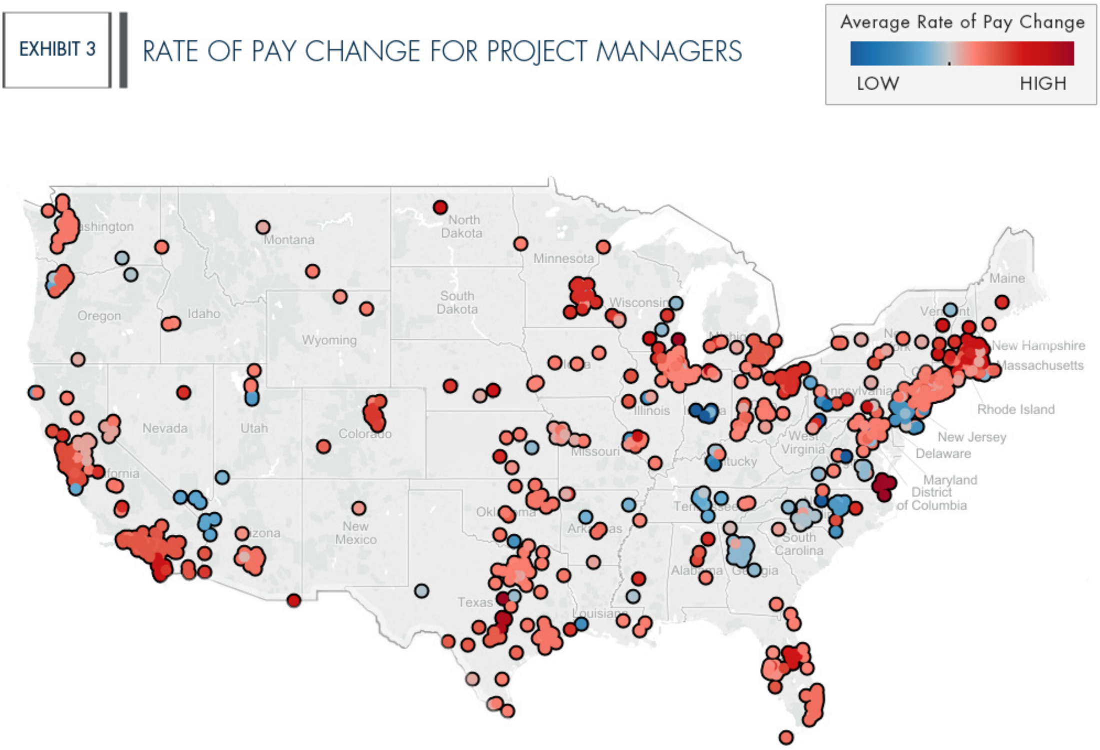
AVERAGE PROJECT MANAGER PAY
(THOUSANDS OF DOLLARS)



Source: FMI Compensation Survey Data

EXHIBIT 3

RATE OF PAY CHANGE FOR PROJECT MANAGERS



Source: FMI Compensation Survey Data

nizations risk underestimating their long-term costs and losing good employees to their competitors, which ultimately can lead to botched jobs and decreased profits.

Trend #3: The Cost for New College Graduates Is High
Construction firms must also pay attention to their employee pipelines, particularly their young employees, who will comprise their future workforces. Not only do college graduates command higher pay (see Exhibit 4), for example, but also the pay for construction management has outpaced other engineering degrees as a result of the demand in the construction industry (and the downturn currently being felt in the oil and gas industries).

Without a clear understanding of competitive pay levels for graduates, construction firms may fail to fill their talent pipelines sufficiently, risk talent shortages, overpay/underpay their workers and risk hurting their bottom lines. Firms should bear in mind that the leaders of tomorrow are the new hires of today and that filling the seats of the next generation of leadership requires hiring today's talented college graduates.

Do Your Research and Develop a Long-Term Compensation Strategy

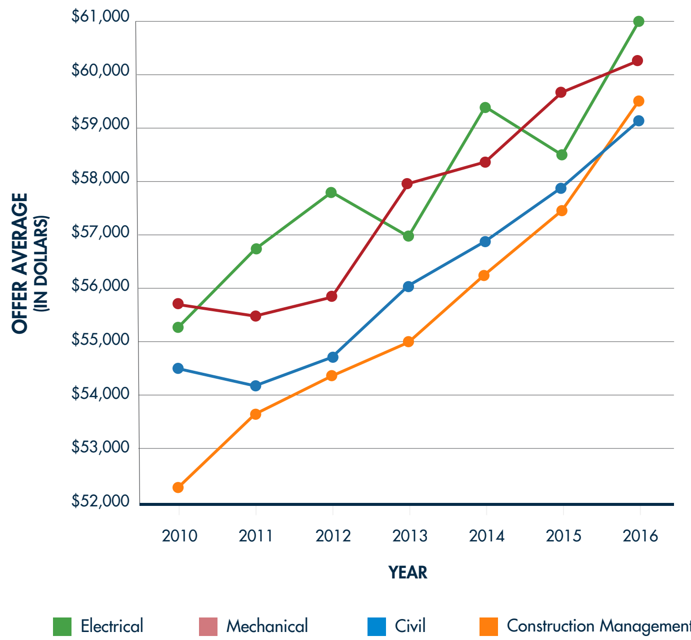
Much like companies compete with one another to sell their products and services, they also go head-to-head for the best and most talented employees. For this and other reasons, a competitive pay strategy serves as the very cornerstone of any good human capital investment approach.

Deep knowledge of labor market data and industry trends is a fundamental building block of an effective pay policy. Such information is available through industry benchmark surveys, for example, and can be used as a foundation for developing customized compensation programs over time.

Deep insights into labor market dynamics can also help contractors increase company performance through well-defined (and competitive!) incentives that motivate their employees to go beyond the call of duty. A well-defined incentive compensation system

EXHIBIT 4

NEW COLLEGE GRADUATE (BACHELOR'S) AVERAGE ENTRY SALARY: TRENDS AND PROJECTIONS



Source: FMI Compensation Survey Data

helps companies develop employees who excel at maximum levels and beyond. It also helps companies more effectively manage the risk of losing good, experienced (or aspiring) staff members.

Finally, as the construction industry continues to recover, markets are becoming increasingly competitive and organizations are facing a litany of new risks. Among the latter are those associated with compensation—namely, either overpaying or underpaying employees. In this fast-changing environment, understanding the pay trends associated with key job families (i.e., business development and project management)—both short- and long-term—can mean the difference between a profitable future and one that's fraught with challenges and unforeseen risk. As we move forward, contractors in the labor management business must pay attention to their total rewards to attract and retain the best talent and realize their desired returns.

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