

Fragile Economy Yields Potential

By Peter Forella



In a market plagued with downsizing, consolidations, repositioning and closures on a scale not seen since the 1930s, one and four construction workers are unemployed and depressed construction prices persist. But while more time is needed to process the scale and breadth of the damage done to the economy, there is visible light from where we are in the tunnel.

Encouraging Trend Lines

The U.S. population continues to expand from birth rates and immigration; and the enormous inventory of existing buildings and infrastructure that serves that growing and changing population continues to age and cycle through expected life. Alone, these two phenomena set the stage for potential construction demand.

Populations that expand and shift set up critical demand patterns. For example, the development of new housing communities stimulates the demand for new roads, shopping centers and banks that spawn all kinds of secondary purchases such as furniture and medical services. These all in turn generate tax revenues to fund schools, county libraries and fire sta-

tions. Ultimately, the increased federal tax revenues enable better airports, harbors and interstate highways that induce international trade efficiencies and so on. Today however, local and state governments are under such financial pressure that they could become part of the problem by encumbering and slowing a fragile recovery. The construction industry should actively encourage local and state politicians to eliminate impedences and disincentives; and public decision-makers should keep an open mind where it makes sense to privatize agency functions and leverage technology to affect efficiencies and cost savings.

Ramping Up Value

The surge in productivity has been induced by the hyper-competitive marketplace. For surviving contractors, business development processes and preconstruction and field operations are more efficient; and payrolls have been optimized. Employees are expected to add more and more value. Figuring out ways to further leverage and imbed knowledge and quality controls into key business processes has become imperative as a consequence of the loss of experienced personnel and shrunken organizational structures.

The strongest firms look for ways to solve owner problems and add more value than their competitors. They create competitive advantage through enhanced insights and develop consultative advantages over firms that have only superficial skills in these areas. Adding and enhancing value for the customer has been migrating all the way through the various supply chains. Good strides have already been made, but more will be needed and expected going forward.

Competing for Investment Capital

Working against and countering the encouraging trend lines is a resistant set of issues that needs to be overcome before any serious recovery is possible in real estate and construction. Pre-eminent on the list is the lack of private real estate investment. Real estate and construction are capital dependent, so the incentives for capital formation, investment and lending must entice those with means (i.e., individuals, corporations and institutions) back into the real estate markets. Investment capital migrates to where returns are favorable and risk is limited, predictable and manageable. Presently, returns and risk levels are not favorable in real estate relative

to other investments, so the capital migrates elsewhere. There is an enormous amount of capital migrating into gold and emerging foreign markets which is not good for domestic real estate and construction.

Core incentives have been outright upended: Is it better to lease or buy? Should we build or consolidate and not build? Do we need all of the buildings in our inventory? Will new taxes and fuel costs undercut the project's financial viability? Time may eventually cure these issues, but there is a lot more the federal, state and local governments can do to breakdown impedances and disincentives currently in play; not doing so will continue to postpone economic growth.

Workforce Quandries

The biggest changes induced by the financial crisis have occurred in the workforce. The construction workforce has suffered structural changes and will present some of the biggest challenges. Of those still employed, many are not employed full time and others have taken on the duties of dismissed personnel. A large percentage of those who were laid off included the more experienced and highly paid. This has left critical institutional knowledge gaps. Field trade labor rates have been driven to historic lows by the current bid markets, causing workers to question the choice of a career on a construction jobsite. This mentality will only discourage and complicate the already challenging recruitment of a future workforce into the trades.

Recruitment shortfalls into the trades over recent decades reached critical proportions during the last three construction booms. Looming workforce shortages were averted by large influxes of foreign workers, predominantly Hispanic. If we were to miraculously experience a construction boom, there would be a significant shortage of qualified tradesmen and professionals, prompting wages to spike in order to entice people back to the industry.

Reality Testing Taxes, Fees, Codes & Regulations

Approximately one-fifth of the total construction value ends up in public coffers during the tax years of field operations. In other words, construction projects generate significant federal, state and local tax and fee revenues.

They also continue to generate property taxes and fee revenues for the entire life of the improvement. Private construction projects are the "gifts that keep on giving." Construction phase tax and fee costs do not include the significant regulatory and code driven costs for mandated improvements imposed by federal, state and local codes and standards. Bear in mind, many public improvements are completed and paid for by private owners through proffers that are extracted by local governments as a condition of their granting site plan approvals to private owners.



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Wouldn't it make sense to evaluate and acid test the scale, breadth and weight of all of these taxes, charges, fees, codes, regulations and proffers to find efficiencies and eliminate redundancies, excesses and abuses? Surely that would stimulate the economy.

Rating the Agencies

Bureaucracies can lose their way. Service to the public gets lost and replaced by mazes of inefficient layers of bureaucracies, regulation and anti-business attitudes. Wouldn't it make more sense to install a standardized performance rating system for critical agency functions, especially for those agencies that regulate companies and economic activities that employ large numbers of people in the private economy?

This information could provide critical feedback loops for the politicians and agency management to better equip them to stimulate economic activity and make operational improvements. Any kind of rating system would need to be kept independent and given teeth to overcome the resistance to change that is inevitable. Perhaps it could be a public – private entity. This type of initiative could help beleaguered politicians and bureaucracies demonstrate tangible, substantive actions helpful to the economy. These new rating processes could also test privatization options and spawn the development of technological and web-based innovations that might replace or streamline expensive, labor intense bureaucracies.

Incentivizing Local Economic Activity

Change can create both pain and opportunity. Unfortunately, there has been a whole lot of pain produced in this case; the evidence is everywhere. The opportunity phase of this situation needs to be developed into coherent strategies to effect substantive economic growth and activity. In other words, there are things private industry groups can do in the form of developing efficiencies and defining expectations of local, state and federal agencies to induce and incentivize local economic activity. Americans have a rich history of rising up to difficult circumstances. Waiting for

ardent but ineffectual politicians and bureaucrats to solve these difficult problems could be a long wait.

Overshadowing our economic future is the specter of increasing federal, state and local debt. With sovereign debt threatening the solvency of European countries, the U.S. may be only a few years behind. Without more credible approaches, the gargantuan levels of debt in the U.S. will crowd-out other spending.

The only solution is a strong, private economy that employs many people, creates wealth, tax revenues and options going forward. Without that, the economic changes recently created will degenerate further.

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