

# Construction Continues to Adapt Amid Increasing Costs and Labor Shortages

BY ERICK BEAUDOIN

*Despite the devastating effects of the ongoing COVID-19 pandemic, which have weighed on the global economy, created volatile indexes, clogged supply chains, shuttered factories, disrupted shipping and limited the sale and movement of goods worldwide, the construction and building products industries in the U.S. adapted and many sectors experienced significant growth during 2020.*



# Takeaways

- 1 Despite the devastating effects of the ongoing COVID-19 pandemic, the construction and building products industries in the U.S. adapted, and many sectors experienced significant growth during 2020.
- 2 Demand for new construction increased in the U.S. and Canada during the pandemic as homeowners considered a transition to less densely populated geographies.
- 3 At the same time, homeowners are investing in existing homes, and repair and remodel spending continues to strengthen.
- 4 While demand for new construction and repair and remodeling activities will continue in the near term, the price of certain building materials is skyrocketing amid a growing labor gap.
- 5 Gordon Brothers conducted an internal survey of its building products clients and found 100% of respondents were bullish on the current expansionary trend continuing in the near term or through the end of 2021.

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s the industry recovers from pandemic-related downturns, the spike in building material and labor costs, attributed to shortages and delays from supply chain disruptions, is expected to continue throughout 2021. Companies across a range of industries are currently navigating higher commodities pricing for lumber, roofing supplies and other building materials while grappling with product delays and labor shortages.



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The broader commercial and residential construction market has performed remarkably well despite the pandemic and ongoing building supply challenges, and Gordon Brothers has seen several trends accelerate, many of which we expect to continue during and post-pandemic.

## Housing Market and Construction Spending Strengthens During Pandemic

With homeowners spending more time working and overseeing remote learning at home, repair and remodel spending continues to strengthen as they invest in existing homes. Additionally, the pandemic is improving the demand for new single-family residential construction as homeowners consider a transition to less densely populated geographies.

By mid-to-late summer 2020, new construction had increased upwards of 30% year over year (YoY) in new home demand and the numbers are still coming in strong.<sup>1</sup> Although housing production in 2021 has softened since January as rising lumber prices continue to affect the housing industry, both private and public residential spending is up 21% YoY.<sup>2</sup>

Despite a slight decrease in construction spending in February because of bad weather and pricier materials, it's still higher than it was

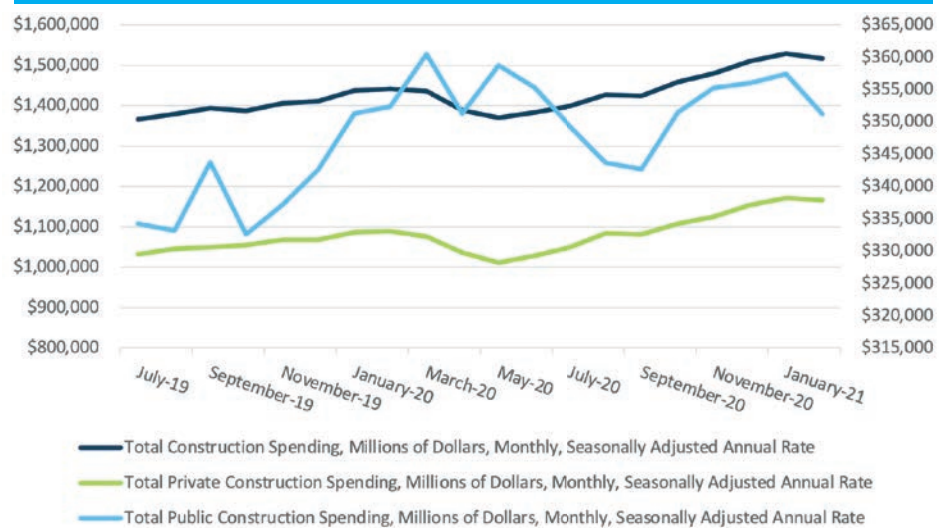
last year. Overall U.S. construction spending is up 5.3% versus prior year levels and private construction is up 7.1% year over year. In January, spending hit a record high of \$1.528 trillion.<sup>3</sup>

These trends are also strong in Canada with the total value of Canadian building permits issued in February setting a record and breaking the \$10 billion mark for the first time. Additionally, the non-residential sector jumped 14.2% to \$3.3 billion in February.<sup>4</sup>

Another positive indicator is mortgage interest rates, which hit historic lows in January, with the average interest rate on a 30-year fixed-rate mortgage at only 2.65%.<sup>5</sup> Since January, mortgage rates have risen by more than 30 basis points, and demand has been affected. Housing activity should remain strong with mortgage rates at record lows, strong federal stimulus spending trends and low housing inventory rates.

Based on the underlying market fundamentals and trends, Gordon Brothers believes demand for new construction and

### Public & Private U.S. Construction Trends



<sup>1</sup> Based on SFNet Asset-Based Capital Conference, March 9, 2021.

<sup>2</sup> U.S. Census Bureau Economic Indicators Monthly Construction Spending February 2021 Released April 1, 2021 <https://www.census.gov/construction/c30/pdf/release.pdf>

<sup>3</sup> U.S. Census Bureau Economic Indicators Monthly Construction Spending February 2021 Released April 1, 2021 <https://www.census.gov/construction/c30/pdf/release.pdf>

<sup>4</sup> Statistics Canada <https://www150.statcan.gc.ca/n1/daily-quotidien/210401/dq210401a-eng.htm?HPA=1>

<sup>5</sup> Freddie Mac, Primary Mortgage Survey <http://www.freddiemac.com/pmms/#>



repair and remodeling activities will continue in the near term and current trends represent a sustained, rather than temporary, shift in consumer behavior.

## Building Products & Material Costs Rise Amid Growing Labor Gap

For certain parts of the country, the industry is a very seasonal business that had been growing over the five-year period ended December 2019 at an annual growth of 1.8%, supported by a housing market that had been expanding steadily since the recovery from the previous 2008 Recession.<sup>6</sup>

Prior to the pandemic, revenue for the building products industry was forecasted to decline slightly in 2020, based primarily on the expectation the housing market and the North American economy would soften.<sup>7</sup> However, building product distributors and retailers were deemed essential, allowing these businesses to remain open during the pandemic.

A variety of trends including home office construction, finishing basements, home improvement because of boredom and moving to suburbs have increased renovation and remodeling spend and have all contributed to the strength of the cycle today.

Additionally, an increase in proposed government spending on infrastructure development should positively impact public construction spending trends and a variety of related building products including aggregate, structural steel, communication and electrical wire, and others.

Gordon Brothers provides appraisals, disposition opportunities and financing in the building supply market. We recently conducted an internal survey of our building products clients and found 100% of respondents were bullish on the current expansionary trend continuing in the near term or through the end of 2021.

A chief operating officer of an upper Midwest building materials dealer noted the following, which summarizes the respondents' collective sentiment.

"While we do not think the repair and renovation market will persist indefinitely at the elevated levels created by the COVID-19 pandemic, our conversations with retail customers and remodeling contractors indicate this will continue for some time," the chief operating officer said. "Many of the remodeling contractors are booked with projects for the rest of 2021 and, with the scarcity of homes for sale on the marketplace, repair and renovation should remain strong for some time."

Pandemic-driven supply chain issues, shipping delays and tariffs are all affecting the price spike in materials. Factories that decreased production when demand dropped in early 2020 with the onset of the pandemic are still not running at full capacity.

Adding pressure to the jump in material prices is a labor gap. Construction companies will need to hire at least 430,000 more workers this year than they employed in 2020. Additionally, construction spending is likely to reach \$1.45 trillion in 2021, up 1.3% from 2020.<sup>8</sup>

In terms of home improvement, Gordon Brothers does not expect to see much change in the high prices of building materials, other than temporary impacts and commodity pricing issues, until supply chain issues alleviate. Construction material shortages are likely to continue throughout 2021 and pricing will accordingly not likely be alleviated anytime soon.

Below is an overview of specific building materials sectors that are affecting the construction and home improvement industries.

## Lumber

Many regions in the U.S. and Canada are facing lumber shortages, and there were several events in 2020 that disrupted an otherwise relatively steady industry.

The sector is recovering from shortages caused by mill lockdown orders and shutdowns, new safety protocols that slowed production, wildfires and lingering timber beetle issues that created shortages and contributed to high lumber costs.

Lumber prices were up over 90% in 2020 and will continue to be in high demand with the increase in new construction. The May 2021 Random Lengths Futures Contract price reached \$1,129 per thousand board feet on April 9, which was more than double the price for the front month lumber futures contract from January.<sup>9</sup>

A U.S. manufacturer of hardwood veneer and hardwood plywood Gordon Brothers partners with expects the current market conditions to exist through the rest of 2021 but expects a trail off in mid-2022 and a return to "normal" levels.

The manufacturer does not believe current supply chain issues will ease anytime soon and has had to make some hard decisions regarding cost structure.

A second privately held lumber production company in Canada explained, while the pandemic has affected lumber prices in their market, it was not the only driver.

The fundamentals for a run on prices were in place before the pandemic started, according to the lumber producer, citing years of just-in-time inventory practices, lumber shortages because of wildfires, beetle infestation and plant closures in recent years.

Additionally, the company noted "70% of the U.S. softwood lumber consumption is in residential construction, and housing starts before the onset of the pandemic were not keeping up with demand." According to the producer, "pricing was going to increase in 2020, pandemic or not."

<sup>6</sup> Gordon Brothers, Building Materials & Supplies Trends Industry Insight <https://www.gordonbrothers.com/insights/industry-insights/commercial-and-industrial-residential-building-products>

<sup>7</sup> Gordon Brothers, Building Materials & Supplies Trends Industry Insight <https://www.gordonbrothers.com/insights/industry-insights/commercial-and-industrial-residential-building-products>

<sup>8</sup> Associated Builders and Contractors analysis of U.S. Bureau of Labor Statistics <https://www.abc.org/News-Media/News-Releases/entryid/18636/abc-the-construction-industry-needs-to-hire-an-additional-430-000-craft-professionals-in-2021>

<sup>9</sup> Source is Wall Street Journal, market data center from April 9, 2021 [https://www.wsj.com/market-data/quotes/futures/LB00?mod=md\\_cmd\\_overview\\_quote](https://www.wsj.com/market-data/quotes/futures/LB00?mod=md_cmd_overview_quote)

<sup>10</sup> Roofing Marketing Outlook 2027 <https://www.alliedmarketresearch.com/roofing-market#:~:text=The%20global%20roofing%20market%20size,rain%2C%20and%20other%20atmospheric%20conditions>

## Roofing

The residential roofing market was forecasted to remain stable in 2020 and, although there were short-term challenges with weather events and demand falling across multiple segments because of the ongoing pandemic, a rebound is expected in 2021. Weather events, especially in the southern states, can have a significant effect on roofing material prices.

The global roofing market size was valued at \$92,942.3 million in 2019 and is projected to reach \$132,775.6 million by 2027, an almost 43% increase.<sup>10</sup>

Demand for roofing was strong in 2020. Owens Corning, which accounts for approximately 20% of the U.S. market,<sup>11</sup> noted the asphalt roofing market grew 8.6% in 2020 driven by a 13.2% increase in weather and storm driven repairs, a 6.3% increase in repair and remodeling demand, and a 9.1% increase from new construction activity.<sup>12</sup> The company expects “continued strength in the U.S. residential housing market with commercial and industrial markets recovering at a slower pace.”<sup>13</sup>

## Granite and Flooring

Fueled by consumer growth in building and remodeling, the granite sector is expected to rise at a considerable rate over the next few years. The global flooring market size was valued at \$388.24 billion in 2020 and is expected to grow at a compound annual growth rate of 6.1% from 2021 to 2028.<sup>14</sup> Respondents to the Gordon Brothers survey in the flooring sector had a bullish outlook, believing their customers “will continue to use their discretionary budgets to invest in their properties and home quality.”

At the same time, they were concerned about a growing labor shortage, which is creating difficulties in responding to strong customer demand, continuing supply chain challenges and an unprecedented increase in transportation costs.

A large U.S. granite and natural stone tile distributor noted net revenue declines of 3.5% in 2020, citing weakness on the west and east coast driven by COVID-19-related disruptions and the closure of two branches. Despite the drop in revenue for 2020, this company had a positive outlook for 2021, noting a double-digit growth forecast for repairs and renovations published by the National Kitchen & Bath Association<sup>15</sup>.

Another respondent to the Gordon Brothers survey agrees with the industry sentiment and expect the growth and interest to remain strong on the repair and renovation side in addition to new construction.

## Housing Market Recovery Uncertain with Volatile Building Supply Market

After an initial period of disruption to demand and the supply chain last year, residential building products have been resilient. Continued uncertainty and supply chain issues in the short term continue to challenge the building supply sector and, ultimately, the new construction and housing markets.

From an outlook perspective, how the housing market recovers from the pandemic is uncertain. The building products distribution market continues to be affected by supply chain issues, tariffs and to some extent, weather. Current interest rates are likely to continue to have a positive effect on the housing market. As the pandemic ebbs and more of life returns to normal, some the impacts on the building supply market that are pandemic-specific may subside.

From an inventory appraisal perspective, Gordon Brothers expects to see continued strength in building products markets, especially as product shortages continue to roil markets and both public and private construction demand remain robust.

In a rising-price environment, liquidation discounting tends to contract as buyers try to secure supply and lock in low pricing. However, there is the potential for a sharp price correction at some point as these high market prices increase capacity utilization and the supply chain issues eventually get sorted out.

Given the volatility in the building supplies market, lenders should be aware of the target company’s costing methods and should consider incorporating a mark-to-market or lower-of-cost-or-market reserve. A mark-to-market reserve account will adjust the cost basis to market and ensure an advance rate, based on a percentage of cost, remains relevant even in a volatile market. ▣

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<sup>11</sup> Owens Corning 10-k <https://d18rn0p25nwr6d.cloudfront.net/CIK-0001370946/de420a24-fc38-4a04-940d-a2c5d8250db9.pdf> and IBISWorld 2020 Roofing Report

<sup>12</sup> Owens Corning Virtual Roadshow Investor Relations Deck, March 9, 2021 [https://s21.q4cdn.com/855213745/files/doc\\_presentations/2021/03/2021-Q1-Presentation-v3.pdf](https://s21.q4cdn.com/855213745/files/doc_presentations/2021/03/2021-Q1-Presentation-v3.pdf)

<sup>13</sup> Owens Corning Reports Full-Year and Fourth-Quarter 2020 Results, February 17, 2021 <https://newsroom.owenscorning.com/all-news-releases/news-details/2021/Owens-Corning-Reports-Full-Year-and-Fourth-Quarter-2020-Results/default.aspx>

<sup>14</sup> Grand View Research Resilient Flooring Market Size, Share & Trends Analysis Report By Product (Luxury Vinyl Tile, Vinyl Sheet & Floor Tile, Linoleum, Cork, Rubber), By Application (Residential, Non-Residential), By Region, And Segment Forecasts, 2019 – 2025 <https://www.grandviewresearch.com/industry-analysis/resilient-flooring-market>

<sup>15</sup> Select Interior Concepts Press Conference March 15, 2021 <https://ir.selectinteriorconcepts.com/static-files/460a428e-f093-4fdd-b7d2-37505e0dcf55>