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Fall/Winter 2021
Construction Market Update

Overall Industry Trends

The booming single-family residential building market that took off with the start of the pandemic has begun to slow, and the market is rotating toward multi-family residential construction. Much of the rotation from single-family to multi-family has been driven by supply chain woes, which led to increased material prices for single-family construction — particularly with lumber. Increased material prices and increased demand for single-family houses also led to increased prices that priced many buyers out of the market. Fortunately, lumber prices have fallen, and if other material costs follow suit, affordability should become less of an issue.

Commercial and educational construction has generally been flat. To address supply chain issues, however, we are seeing increased construction in domestic manufacturing and warehouses and distribution. Additionally, construction executives see increasing construction in healthcare, transportation, and water and sewage treatment.

Infrastructure

On November 15, 2021, President Biden signed the new infrastructure bill. While specific spending will depend largely on administrative decisions, some of the broad categories include:

- $110 billion for roads, bridges and highways
- $90 billion for public transit, including improvements to improve accessibility
- $66 billion for rail improvements
- $65 billion for the electrical grid
- $65 billion to expand broadband access into less accessible areas
- $55 billion to improve drinking water infrastructure
- $25 billion for airports
- $17 billion for ports
- $7.5 billion for electric vehicle charging stations

For more specifics, see What's In The Infrastructure Bill 2021 Breakdown? (thomasnet.com)

Many of the items in the bill also pay for non-construction work, such as money to purchase electric school buses. Construction spending will begin with the design firms before filtering down to the contractor level, but contractors should include this work in their medium and long term planning.

Vaccine Mandate

While the courts have stayed implementation of OSHA's Emergency Temporary Standard (ETS), any contractor performing work on a federal contract valued at more than $250,000 will need to comply with the new Federal Acquisition Regulation (FAR) clause, 52.223-99. This is included in all solicitations issued after October 15, 2021, including any extensions or renewals of such contracts. Additionally, GSA has issued a mass modification forcing contractors with Multiple Award Schedule contracts to incorporate the clause in their contracts or be dropped from the GSA website and to not be eligible for future orders. COVID-19 Safety & Vaccine Requirements for GSA & Federal Contracts (federalschedules.com).

The FAR clause provides:

The contractor shall comply with all guidance, including guidance conveyed through Frequently Asked Questions (FAQs), as amended during the performance of this contract, for contractor or subcontractor workplace locations published by the Safer Federal Workforce Task Force (Task Force Guidance) at https:/www.saferfederalworkforce.gov/contractors

Under the Current Guidance

Federal contractors and subcontractors with a covered contract will be required to conform to the following workplace safety protocols:

1. COVID-19 vaccination of covered contractor employees, except in limited circumstances where an employee is legally entitled to an accommodation;
2. Compliance by individuals, including covered contractor employees and visitors, with the guidance related to masking and physical distancing while in covered contractor workplaces; and
3. Designation by covered contractors of a person or persons to coordinate COVID-19 workplace safety efforts at covered contractor workplaces.

In the FAQ, the task force clarified that covered employees include those employees who perform duties necessary to the performance of the covered contract, but who are not directly engaged in performing the specific work called for by the covered contract, such as human resources, billing and legal review. Employees working solely from home are required to get vaccinated and there are no exceptions for individuals who may have natural immunity from a prior infection.

Federal contractors currently have until January 4, 2022 to ensure that all employees are vaccinated. Given the large number of construction workers who have chosen not to get vaccinated and the already tight labor market, this clause promises to make performance of federal contracts very challenging.

Insurance and Bonding Markets

Certain areas of insurance are becoming more costly. Cybersecurity has become ever more important, but the cost of cyber liability insurance has increased and it is becoming less available. Likewise Professional Liability insurance is becoming ever more expensive.

On the other hand, the surety market has remained stable. We are concerned that the vaccination mandate in federal contracting will make it very difficult to perform for many of these contracts. If the federal government aggressively audits compliance, it could lead to multiple defaults and severely impact the Miller Act performance bond market.

COVID-19 and Subcontractor Defaults

Thus far, we have not seen much in the way of subcontractor defaults due to fallout from COVID-19, but we expect to see such defaults soon. Such defaults are likely to arise from price escalation, material shortages, and labor shortages. Also, subcontractors engaged on federal contracts may not be aware of the vaccine mandates added to the FAR, and may not have accounted for the impact on its labor force that enforcement of the mandate would have. With respect to each of the issues.

Price Escalation

Price escalation has continued to wreak havoc on the industry, but there is a new component that makes planning even more difficult. While we saw rapid escalation in softwood lumber and other wood products, like plywood, we are now starting to see rapid de-escalation. Softwood lumber is the first example. As of June 2021, there had been a 125% price increase, but then prices dropped 29% in July and an additional 27% in August.* Structural steel prices have also surged over the course of 2021, but increased steel production is expected to result in prices dropping back to pre-pandemic levels by the end of 2022.

One emerging issue involves aluminum. Aluminum is derived from bauxite, much of which is mined in Guinea. A military coup in Guinea sent shockwaves through the market, but a more pressing issue may be a magnesium shortage. Magnesium is necessary to strengthen aluminum so that it can be used in structural applications, and aluminum manufacturers are now warning their customers that a magnesium shortage will impact production. Aluminum sheet is already up 35% on an annual basis,* and we can expect much more significant increases if the magnesium shortage is not resolved.

Contractors can protect themselves from price increases by locking in prices at bid time and negotiating clauses allowing for price adjustments through escalation clauses. Owners and prime contractors should also consider protecting themselves by requiring subcontractor performance bonds. Finally, while subcontractors affected by price spikes and supply shortages may not have a legal right to relief, owners need to recognize that failure to give some relief may cause subcontractors to default, in which case they will need to pay a higher price to a replacement subcontractor (assuming one can be found), and the project will be delayed. In short, all parties may need to share the loss both for the "good of the project" and to make sure the contractors and subcontractors are there for the next project.

*ENR Economics 2021 Third Quarterly Cost Report

Supply Chain Disruptions

Price escalation is to a large extent driven by supply chain disruptions. Since August, the Port of Los Angeles has repeatedly set new records of the number of container ships floating off the coast waiting to unload. The cost of a shipping container has increased to several times what it was before, and warehouses in the inland empire area have run out of space to store containers that have been offloaded and which are waiting for trucks to take them to their eventual destination.

This, along with the semi-conductor shortage is having an impact on all parts of the industry (although it appears that the semi-conductor shortage is easing). Controllers for automatic systems are scare, and deliveries of new construction equipment are being delayed due to supply chain issues. As a result, equipment fleets are aging, and fewer machines are hitting the secondary market. Those machines being auctioned off are also older than they were in the past.

The result of these disruptions is that lead times for ordering certain components are no longer reliable. To address delays from supply chain disruptions, owners and contractors should be prepared to order materials and equipment well before they are needed and be prepared to finance stored materials and equipment. Agreements relating to stored materials should be carefully drafted to require the person storing the materials to segregate them from other stock in case the subcontractor who ordered the materials or the person holding the materials goes out of business. Additionally, the agreement should specify responsibility for insuring the stored goods from loss due to fire or another casualty.

Labor and Management Shortages

Labor shortages continue to plague the industry. Thus far, wage rates have increased at only a modest rate, with the greatest increases going to unskilled labor. In many metropolitan areas, wages in retail and restaurant work have increased to $18-$20 per hour, and contractors are finding themselves competing with those industries for unskilled labor. Accordingly, the modest increases experienced thus far may turn into much higher increases later.

While much of the focus has been on skilled and unskilled labor, contractors are experiencing a real war on managerial talent. A persistent effort is required to retain top talent. Studies show that one key to retaining managerial talent is to provide each employee with opportunities for growth and advancement. This requires training and establishment of periodic goals with rewards for meeting or exceeding those goals. Profit sharing based on project performance has also become an important part of making sure employees stay on through project completion.

IoT — Internet of Things and Construction Safety

The Internet of Things (IoT) connects real world items to the web, and many of our construction insurers are starting to drive use of IoT to enhance safety and reduce losses. A good brief introduction to this topic can be found at IoT Technology Will Improve Safety and Efficiency on the Construction Site - (Bing video). For those who would rather read than watch, however, IoT is using sensors on humans and machinery for presence detection — i.e., to know where people and things are located on the site to help prevent unnecessary contact. Examples include moving machines and static openings. In that regard, we want IoT to provide actionable information that will allow workers to adjust to threats and to help management detect potential hazards.

The initial push for IoT in construction was to improve efficiency through machine control — often used in heavy construction to control machines to get more precise movement — and site monitoring to monitor variables like weather, vibration and pile movement. https://www.unearthlabs.com/blogs/iot-in-construction

The next push is toward safety — often equipping workers with wearables like smart watches or clip-ons that monitor personal data and report it wirelessly. These wearables can sound alarms to notify workers of restricted or hazardous areas. They can also log interactions between workers for contact tracing and job hazard analysis. Attached to equipment, these tags can monitor usage and notify supervisors if operators are violating the rules. If safety measures fail, these items can also be used to alert managers of an injury to expedite an emergency response or to evacuate a jobsite.

While we do not endorse any particular technology, these benefits are explained in marketing materials for various companies, E.g., Construction » Triax Technologies; Wearables in Construction: Industry Trends (aerialliftcertification.com)

We are now seeing insurers pushing use of this technology to reduce loss exposure.

Wage Theft Laws

We are also seeing an increasing number of states enact "wage theft" laws making prime contractors directly liable to subcontractor employees who have not been paid. Some of these laws contain safe harbor provisions, where the contractor can avoid liability by obtaining certifications from the subcontractors that they have paid all laborers. Other states, however, are making the prime contractor strictly liable. States that have recently enacted such laws include Virginia, whose law became effective on July 1, 2020, and New York, which adopted such a law in September 2021.

Prime contractors can protect themselves from such claims through strict subcontract provisions requiring payment of all employees in accordance with the law, and indemnity provisions calling for indemnification if the sub or any of its lower tier subcontractors fail to make payment. Because a subcontractor not meeting payroll is unlikely to have the resources to reimburse the contractor, contractors should require performance bonds and consider amending retainage clauses to allow the contractor to retain payment until evidence of payment to employees has been provided. It is highly recommended that contractors start requiring their subcontractors to provide certified payrolls to verify proper payment.

Employee classification is an emerging issue with these laws. Under the federal Davis-Bacon Act, an employee must be paid the prevailing wage for the type of work they are doing. For example, an employee who performs work for the concrete sub may need to be paid carpenter wages when building forms and cement mason wages when pouring and finishing concrete. Under the federal Fair Labor Standards Act (FSLA) and many state laws, even salaried employees are considered "non-exempt" and may need to be paid overtime. Prime contractors have always been liable for federal Davis-Bacon misclassification by their subcontractors, but not always for state equivalents and certainly not for misclassification of non-exempt employees under the FSLA. These wage theft laws, however, give employment plaintiff's lawyers new routes to seek recovery from prime contractors for their subcontractors' misclassification under the FSLA and state-law versions of Davis-Bacon.

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