

Construction & Real Estate Services

July 2020

Overview

As the economy-at-large closed to limit the spread of COVID-19, construction and real estate activity was severely hindered despite being considered essential in some states. As the economy reopened and borrowing rates were held at low levels, several delayed or suspended projects resumed.

Businesses that have delayed projects are rushing to resume and complete builds while interest rates are low. However, real estate activity remains in flux as a number of retail and commercial businesses are looking to move their operations online or continue remote work, while they decide whether to continue renting. ProcurementIQ has outlined the key risks affecting prices in these markets.

Price Risk Score

3.5

Medium-high price risk increases the likelihood of price volatility as suppliers have the leverage to raise prices when profits are threatened due to high specialization and low availability of substitutes.

Price Risk At a Glance

-  **Demand risk** is very high as large-scale construction projects and real estate transactions are procured by businesses. A shift in business demand threatens margins, which could pressure suppliers to adjust prices accordingly.
-  **Input risk** is relatively low as dwindled demand has reduced the consumption of building materials.

Contents



Price Risk Scorecard.....3



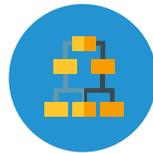
Labor Risk Assessment.....4



Scarcity/Availability Risk Assessment.....5



Demand Risk Assessment.....6



Input Risk Assessment.....7



Price Disruption Scale.....8

Price Risk Scorecard

How would a second wave impact price risks in the Construction and Real Estate market?



Labor Risk

Factor	Risk Level	Score
Reliance on Labor	Medium-High	3.3
Wage Costs	Medium	2.9
Overhead Costs	Medium	2.9
Reliance on Manufacturing*	---	---

* Factor has intentionally been omitted from scoring due to the service-based nature of the market

3.0

Weight
25%

Scarcity/Availability Risk



Factor	Risk Level	Score
Lead Time	Medium	3.1
Warehousing Ability*	---	---
Imports*	---	---
Substitutes	Very High	4.3
Specialization	High	3.8

* Factor has intentionally been omitted from scoring due to the service-based nature of the market

3.7

Weight
20%

Demand Risk



Factor	Risk Level	Score
Business Demand Reliance	Very High	4.7
Consumer Demand Reliance	Low-Medium	2.6

4.2

Weight
35%

Input Risk



Factor	Risk Level	Score
Input Prices	Low-Medium	2.7
Supply Chain Risk	Low-Medium	2.7
Financial Health	Low-Medium	2.7

2.7

Weight
20%

Overall Price
Risk:

3.5

Medium-High

Labor Risk

Factor	Risk Level Explained	Key Indicators
Reliance on Labor Measures the need for on-site staff, rather than remote workers or automated machinery.	Suppliers' medium-high level of risk stems from moderate-high reliance on labor, which is driven by hiring trends across the United States.	<ul style="list-style-type: none">• A homebuilder survey found 64.0% of construction firms cited problems with the willingness of workers and subcontractors to report to a construction site.• In April, the Construction sector shed 975,000 jobs, with specialty trades being hit the hardest, losing 690,500 jobs.• Despite rising layoffs in March, residential construction hired 2,000 workers.
Wage Costs Represent the percentage of suppliers' revenue that must be dedicated toward paying workers.	Suppliers' moderate impact from wage costs is driven by the moderate proportion of wages as a share of revenue.	<ul style="list-style-type: none">• Some construction staff have had their salaries cut, while others have been furloughed. Staff placed on furlough will be paid through the government's Payment Protection Program.• Because construction has been deemed an essential service during the COVID-19 pandemic, laborers have been demanding hazard pay for work involving physical hardship and elevated health risks.
Overhead Costs Refer to the fixed and variable costs suppliers incur to support their operations.	Suppliers' moderate impact from overhead is driven by the moderate proportion of overhead as a share of revenue.	<ul style="list-style-type: none">• Due to decelerated demand for construction activity, the price for heavy machinery and subcontractor labor has declined.• Due to a rise in demand for freight transportation services during the COVID-19 pandemic. Construction workers have incurred higher freight costs associated with transporting materials and equipment to the project site.• Overhead costs related to Real Estate activity have declined considerably as agents have adopted remote work processes (e.g. online meetings, online document sharing programs and virtual tours).

Takeaways



Moderate reliance on labor indicates that vendors could push to complete existing projects quickly to avoid operational disruption in the event of a second wave.



Moderate labor risk indicates that wages and overhead costs will have some impact on price trends in the event of a second wave.

Scarcity/Availability Risk

Factor	Risk Level Explained	Key Indicators
Lead Time Measures the average amount of time between a buyer creating an RFP and delivery of market services.	The market's moderate level of risk associated with lead time is driven by the moderate likelihood of delays within the market.	<ul style="list-style-type: none">• There were a number of states (e.g. New York), which has deemed construction nonessential or only allowed for limited construction activity while under shelter-in-place orders. These mandates have pushed back project completion times and prompted contractors to add force majeure clauses to construction contracts.• With regard to commercial real estate closings, buyers increasing their use of floating closing dates as many are facing delays in inspections, notarization activities and the drafting of insurance policies.
Availability of Substitutes Measures the ease with which buyers can use different services to fulfill the same need.	Suppliers face a very high level of availability risk in this market due to the very low availability of substitutes.	<ul style="list-style-type: none">• Project postponements and cancellations are now commonplace. As a result, a number of suppliers currently have a construction backlog.
Specialization A measure of the level of customization needed for each buyer of market services.	The high level of specialization in this market contributes high risk because the scope of market services is unique for each project.	<ul style="list-style-type: none">• To avoid the suspension or prolonged delay of construction projects, suppliers have put in place a number of safety protocols to protect workers. For example, a number of contractors have established protocols for disinfecting equipment and machinery, staggered start times and shift work, controlled access to worksites and increased security.• Due to supply chain disruption, suppliers are adapting the use of pre-fabricated materials when possible.

Takeaways



A very low availability of substitutes for these services indicates a low likelihood of price deflation during a rebound in cases.



The high level of specialization may increase the number of hours billed per project, thereby raising costs to buyers, as suppliers must adhere to new protocols and adapt construction materials.

Demand Risk

Factor	Risk Level Explained	Key Indicators
Business Demand Reliance A measure of necessity for the given services to properly operate downstream buyers' businesses.	The market's very high impact from business demand reliance is driven by the high amount of revenue generated through B2B sales.	<ul style="list-style-type: none">• Some commercial real estate sectors, such as hotels and retail, was hit hard immediately while others were relatively stable with long-term lease protection. Industrial appears to be relatively defensive compared to other sectors.• As interest rates were reset to record lows, demand for commercial real estate brokerage activity has increased. In the primary asset classes (industrial, office and retail) there has been a marked increase in sales activity with the only limiting factor being supply – particularly in the industrial sector.• Due to an abrupt shift in business demand among industrial businesses, the workforce has contracted from 1.1 million in April 2019 to 992k in April 2020.
Consumer Demand Reliance A measure of necessity for the given services for the average consumer.	The market's low-medium impact from consumer demand reliance is driven by the low-medium amount of revenue generated through B2C sales.	<ul style="list-style-type: none">• Some homebuyers, especially those signing contracts on new builds, are seeing loan rates below 3.0%.• Low mortgage rates have caused a push in refinance and home renovation activity.

Takeaways



A very high level of business demand reliance means construction firms are vulnerable to sustained stoppage of economic activity caused by a resurgence of cases.



High demand risk indicates vendors the level of competition will surge if the number of projects shrinks.

Input Risk

Factor	Risk Level Explained	Key Indicators
Input Risk A measure of the fluctuations in costs associated with inputs used to perform a service.	Suppliers' low-medium level of input price risk is driven by the low level of volatility in input costs and the moderate proportion of revenue devoted towards purchasing costs.	<ul style="list-style-type: none">The price of construction materials and equipment has fallen for the first time in 40 months due to the COVID-19 pandemic. Key building materials in decline include: fabricated structural steel, carbon steel pipe, copper-based wire and cables.
Supply Chain Risk The measure of risk associated with purchasing from upstream suppliers and selling to downstream buyers.	Suppliers' low-medium level of supply chain risk stems from the moderate levels of risk among key buyers.	<ul style="list-style-type: none">From March through June as producers were effective in auctioning existing heavy equipment and machinery inventory online to avoid inventory oversupply.Industrial activity fell sharply, as the coronavirus pandemic and other problems weighed on the mining and manufacturing sectors.
Financial Health A measure of the financial standing of an average provider of market services.	Suppliers' low-medium level of financial health risk is driven by a decline in corporate profit levels.	<ul style="list-style-type: none">Businesses continue to operate, but social distancing is a barrier to business investment and expansion.A number of retailers are not paying their rents due to financial uncertainty.Low interest rates are encouraging real estate brokerage activity.While a number of suppliers reduced their labor force as an immediate response to the loss of business during COVID-19, some vendors were able to obtain funding from the Paycheck Protection Program, which covered operating costs while shelter-in-place orders were in effect.

Takeaways



Construction materials and equipment have declined in price as sluggish demand has created a surplus.



Low-medium input risk indicates that operators are in a good position to absorb supply chain shocks in the event of a second wave.

Price Disruption Scale

How do the price risk scores across submarkets compare to the overall score for the Construction and Real Estate market?



Construction Project Management Services 3.0 – MEDIUM

This market displays a moderate risk of price disruption in the event of a second wave due to as a low reliance on labor is offset by a strong dependence on demand from businesses. Given the fact that project managers have great control over operating costs, firms have been lowering prices beginning in February 2020 as indicated by a 0.5% decrease in prices from February 2019 to 2020.

Overall Price Risk Score: 3.5



Construction & Real Estate Services

Although the Commercial Real Estate Rental submarket is scored low/medium, the elevated price risk scores of all other submarkets lead to **moderately high** price risk in the wider Construction & Real Estate Market.



Commercial Real Estate Rental Services 2.8 – LOW/MEDIUM

This market's low-moderate risk of price disruption is due to already weakened demand for office space and other commercial rentals. The federal government and the Federal Reserve have put in place several measures to contain the economic fallout and keep businesses afloat. Further, there is little risk of transactional delays as contracts and viewings can be conducted online. Still, the high risk of business demand volatility has led some vendors to keep prices flat to encourage renting.



Painting Services 3.5 – MEDIUM/HIGH

This market displays a near high risk of price disruption due its high reliance on labor and the fact that wages during the first wave grew due to hazard pay requests from workers. That said, risk is tempered by moderate input risks as suppliers have sufficient paint inventories due to faltered demand and are in a position to wait for new product without having to pay more for rush shipments. Due to the relatively fast recovery in demand among homeowners, suppliers have not adjusted their pace of price growth.



Oil & Gas Facility Construction & Maintenance 4.0 – HIGH

This market's high risk of price disruption stems from exposure to supply chain risks that could raise total project cost and extend lead times. However, the impact will vary for buyers based on the project's degree of specialization. Some vendors have increased prices for their services by over 90% from 2019 to 2020.