2020 Construction Industry Forecast

WELLS FARGO

Table of Contents

A year of cautious optimism

For the 44th annual Wells Fargo Construction Industry Forecast,

we are pleased to report that industry executives from 47 states responded to our in-depth survey about the construction industry. The primary goal of the survey is to determine the 2020 U.S. National Optimism Quotient (OQ), which is used to measure the degree of optimism in the nonresidential construction business for the coming year. In addition to determining the OQ, the survey also posed questions about equipment sales and purchase expectations, trends in the rental market, and explored major cost and risk concerns that industry participants are keeping top of mind as they prepare for 2020.

After a record high projection for 2018, the last two years have seen a decline in optimism, though, in spite of this change, executives remain cautiously optimistic when looking ahead to 2020. This year's OQ comes in at 99 indicating cautious optimism. A number of 100, just one point higher is considered strong optimism for increased local construction activity. We consider this year's OQ to be trending toward signs of optimism, albeit slightly cautiously. The decline in optimism is most notable in executives' opinions from the Southern region, among Non-Energy states, and companies with $25M+ in annual revenue. The statistically significant uptick in those who believe that nonresidential construction activity will decrease is apparent among both contractors and distributors, with contractors predicting a 10% decrease in 2020 construction activity (vs. 3% in 2019) and distributors predicting a 17% decrease (vs. 4% in 2019).

It's worth noting that the 2020 presidential election plays a prominent role in driving executives' pessimism about the construction industry's future. Many express that the state of the construction industry over the next few years depends on the result of the 2020 presidential election. Of the respondents, 90% indicate that the 2020 election will have somewhat (43%) or a great deal (47%) of impact on the industry. This is reminiscent of what we have heard in past election years, including 2016, where we saw an OQ drop from 130 to 108.

Other top risk and cost concerns are certainly worth noting. As previously mentioned, political and regulatory uncertainty registered as the top risk concern for the construction industry, according to 35% of respondents. The other top risk concerns include the availability of qualified workers (25% of respondents), and economic uncertainty (21 % of respondents). Ability to hire qualified workers remains as the main cost concern among contractors (54% of respondents), where distributors primarily worry about equipment costs (25%), employee wages/benefits (21%), and healthcare costs (20%).

In regard to equipment acquisition, there has been a notable decline in optimism about sales and purchases, as well as rentals of construction equipment in 2020 among both distributors and contractors. We found that 52% of contractors believe that their purchases of used construction equipment will remain the same next year.

Distributors are more mixed in terms of their expectations for sales of used construction equipment with 46% expecting an increase, but 48% expecting to remain the same. In terms of purchases of new construction equipment, 40% of contractors expect purchases to remain the same, where distributors are again mixed with 32% expect to remain the same, but 40% expect an increase. As in 2019, a stronger backlog of jobs and long-term confidence in the local/national economy are the key factors that would encourage purchases of construction equipment.

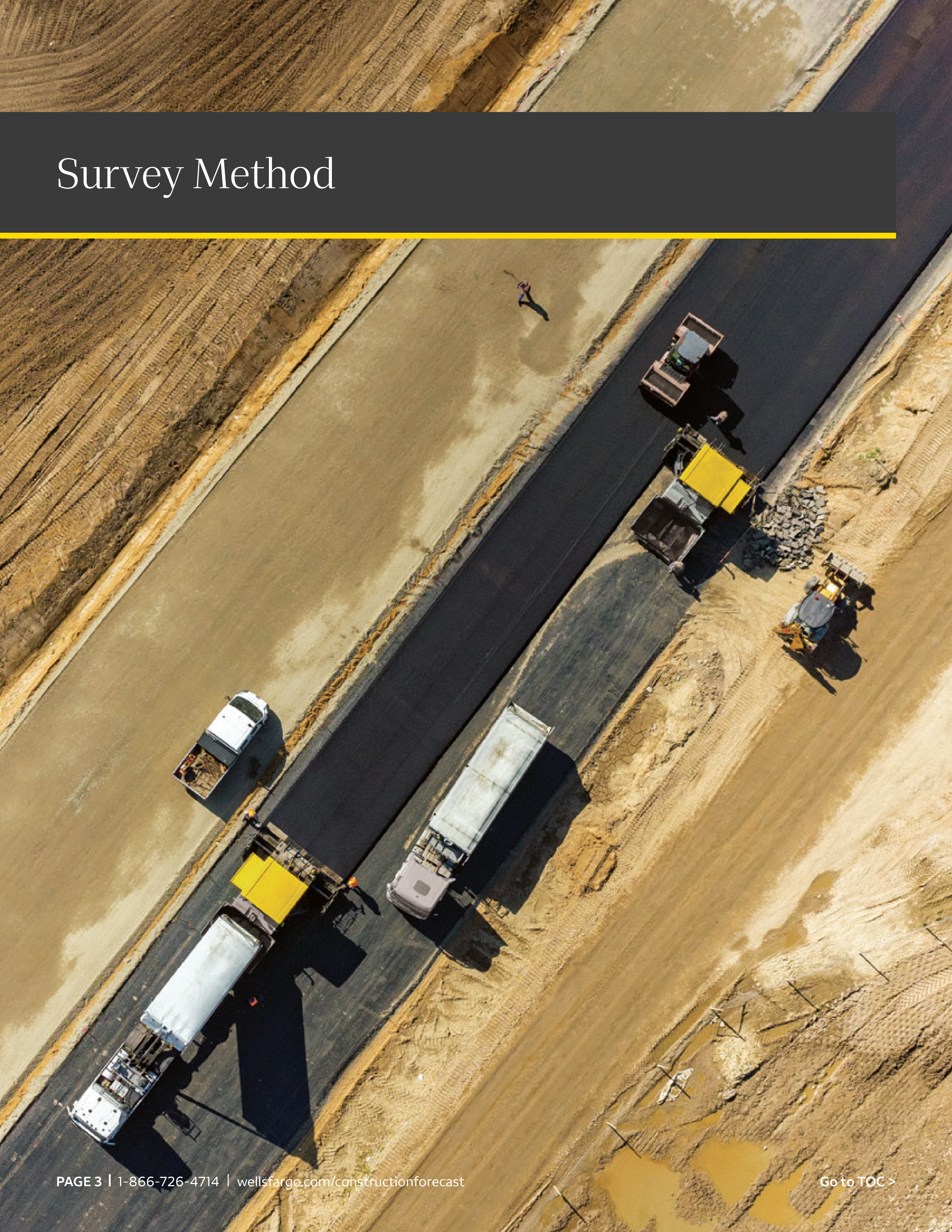
2020 appears to show a slight downtick in optimism among both contractors and distributors, but not at a level that should cause great concern. With the pending election later this year, it's no surprise that there is a sense of unknown and concern across the industry. Please take a close look at the details in this full report to weigh your future business decisions against what the industry has to say.

As always, please reach out with any questions you have about the survey. We are glad to share our perspective and interpretation of the results at your convenience.

Jim Heron
National Sales Manager
Construction Group
Wells Fargo Equipment Financing
612-667-3477
james.t.heron@wellsfargo.com

Jim Heron

Survey Method



Overview

The survey results presented in this 2020 Construction Industry Forecast represent the 44th year in which Wells Fargo Equipment Finance and its predecessors have surveyed construction industry executives to gather insight into current business conditions and trends, and to measure their sentiment toward construction activity in the coming year. This year, survey responses came from 305 construction industry executives in 47 states and nearly all respondents report that they have been in the construction industry for five years or more. Note: The margin of error for this survey varies among respondent groups, but does not exceed 14% (95% confidence level).

Respondent classifications

Contractors are companies that execute construction projects. Producers of aggregate materials and other companies that rely on heavy construction equipment also fall into this category. These companies often buy, lease, or rent large construction equipment to complete such projects.

Equipment rental companies acquire equipment to rent out to contractors.

Distributors are dealers of construction equipment. These companies most often sell heavy equipment, light equipment, or general construction equipment, and provide a range of products and services to the construction industry. It is very common for distributors to also have rental as part of their business strategy.

Manufacturers create or build the equipment that contractors use.

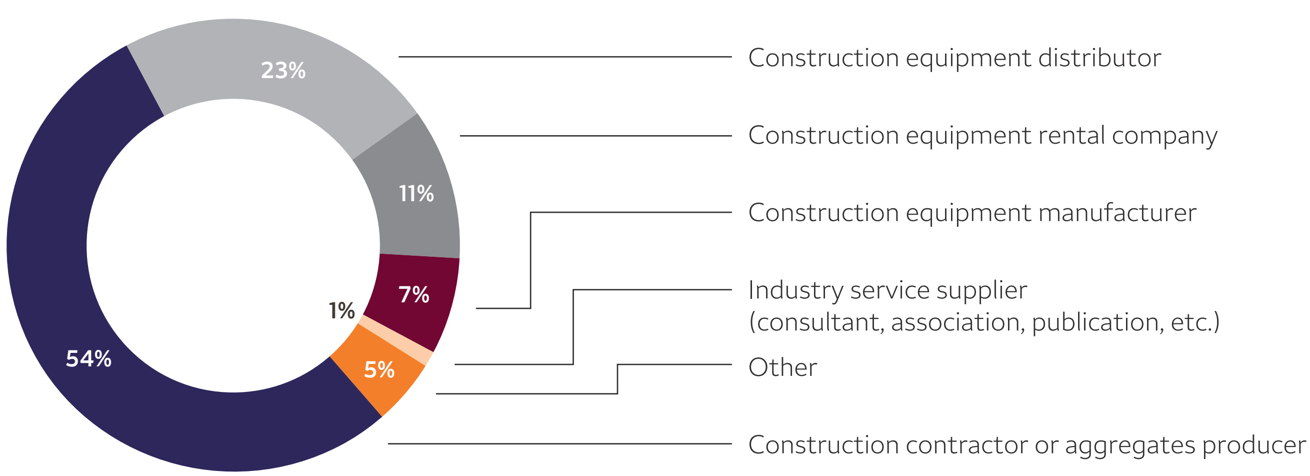
Survey dates

November 13 – December 5, 2019

Composition of survey respondents

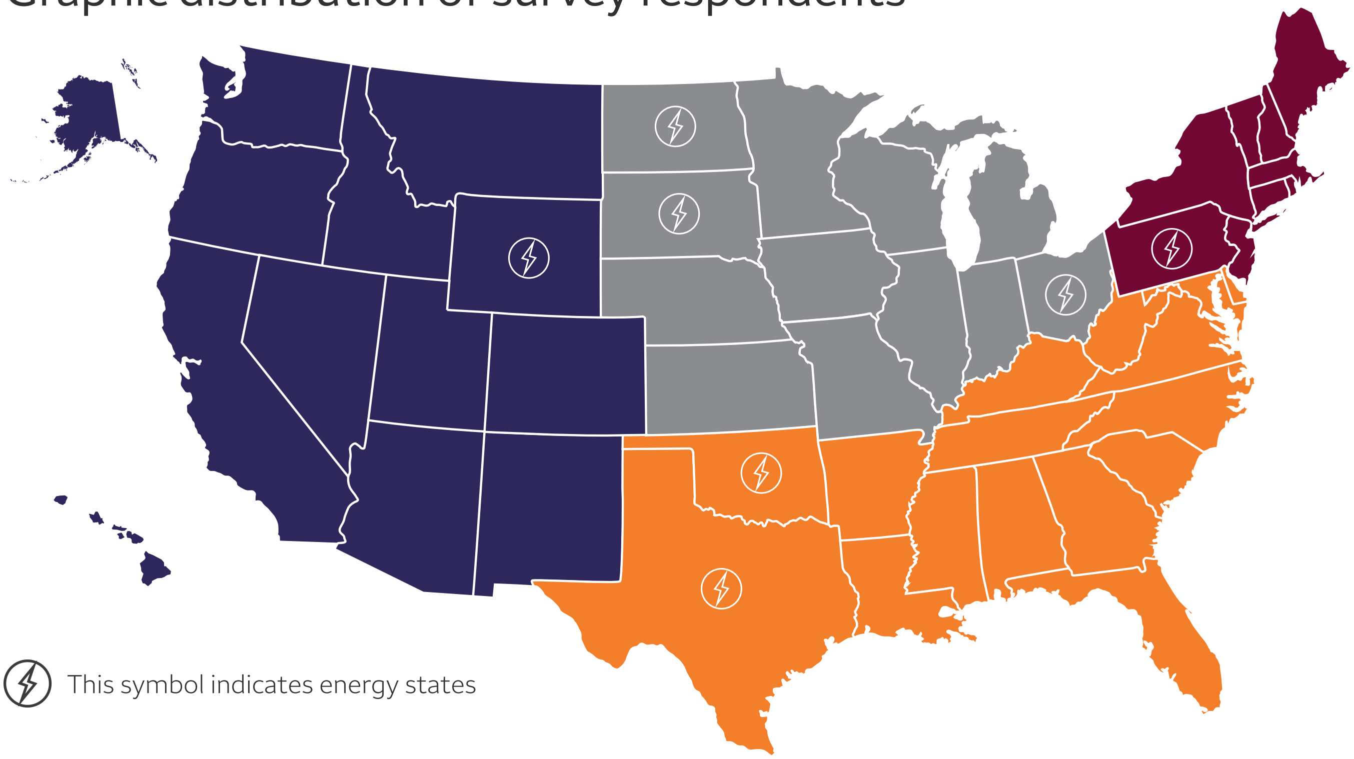
Most respondents (98%) have been in the construction industry for five years or more. Site preparation/excavation and heavy highway are the most common industries among respondents.

What best describes your company's primary function in the construction industry?



Percentages may not add up to 100% due to rounding. For questions regarding this Wells Fargo Equipment Finance survey, please contact Wells Fargo Equipment Finance Marketing at wfefmarketing@wellsfargo.com.
The number of construction industry businesses with five or more years is 98%, 2% with less than five years. Base: 305 respondents

Graphic distribution of survey respondents



This symbol indicates energy states

■ **West — 26%**
AK, AZ, CA, CO, HI, ID, MT, NM, NV, OR, UT, WA, WY

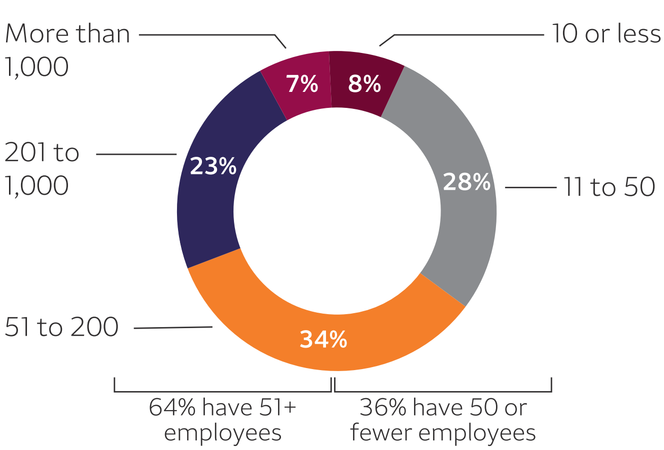
■ **Midwest — 19%**
IA, IL, IN, KS, MI, MN, MO, ND, NE, OH, SD, WI

■ **South — 41%**
AL, AR, DE, FL, GA, KY, LA, MD, MS, NC, OK, SC, TN, TX, VA, WV

■ **Northeast — 13%**
CT, MA, ME, NH, NJ, NY, PA, RI, VT

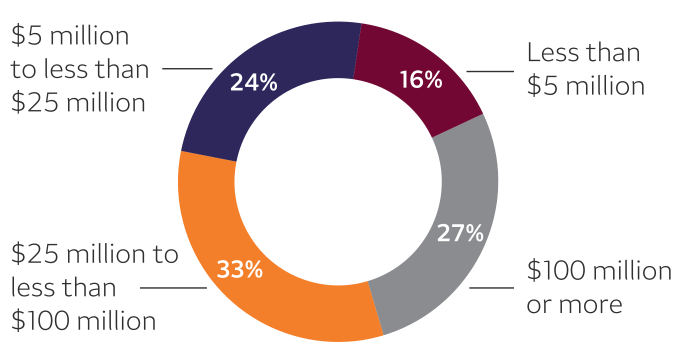
Responses were received from 47 states. No responses were received from respondents whose offices were headquartered in Mississippi, Oklahoma, and Rhode Island for 2020. Washington, D.C. was not included. Note: The following are the proportions of survey responses from energy states: 17% (2020), 17% (2019), 23% (2018), 24% (2017), 17% (2016), and 22% (2015). Base: 305 respondents

Which of the following categories best describes your company's total number of employees?



Base: 305 Respondents

Which of the following categories best describes your company's annual revenue?



Base: 305 respondents

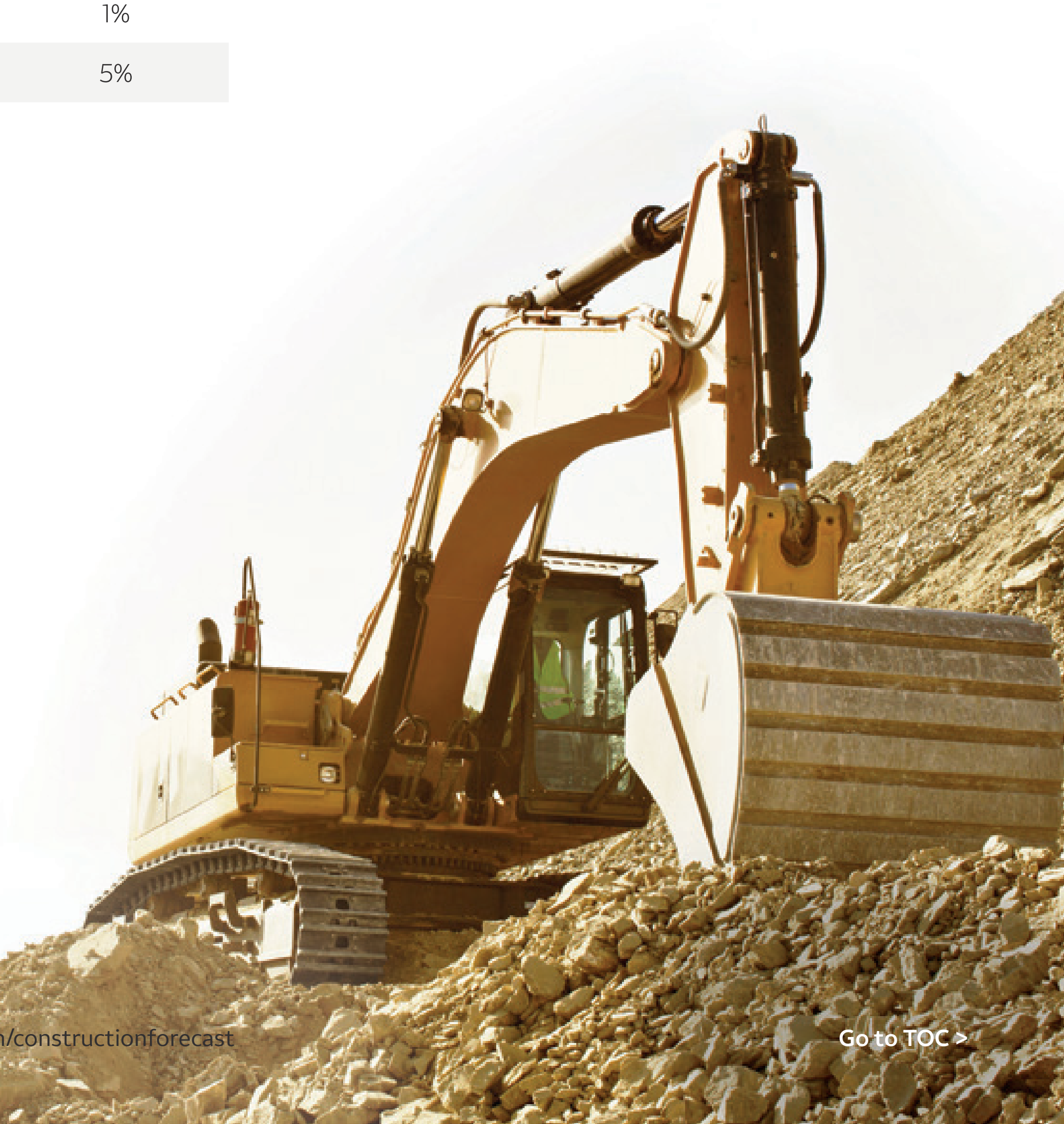
In which of the following industries do you do the most work?

Category	2019
Site preparation/excavation	27%
Heavy highway	24%
Concrete and asphalt	10%
Nonresidential building	10%
Utility contracting	7%
Residential building	5%
Bridges and overpasses	4%
Oil and gas	4%
Mining	2%
Aggregates production	2%
Materials transport	1%
Other	5%

What important changes do you believe will occur in the construction industry over the next two years?

"Tough question. We believe a lot depends on the 2020 election and how the trade agreements progress."

— **SURVEY RESPONDENT**



The 2020 Optimism Quotient is 99

2020 — A year of cautious optimism

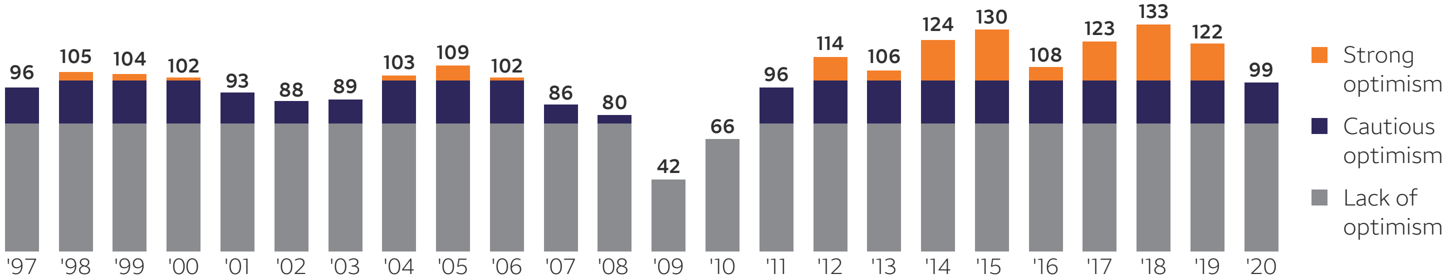
The Optimism Quotient (OQ) — this survey's primary benchmark for measuring contractor and equipment distributor sentiment on local nonresidential construction activity — is 99 overall for 2020, indicating this is a year of cautious optimism. The base for this benchmark measure is 75 and any score 100 or above is considered highly optimistic. Notably, in 2020, Contractors are considered to be highly optimistic with an OQ score of 101 and Distributors are slightly less optimistic with a score of 97.

Construction activity is expected to hold strong for the next year in spite of uncertainty seen commonly in election years. In 2016, optimism dropped from 130 to 108. While on par with expectations for an election year, the decline in the OQ score from 122 in 2019 to 99 in 2020 is most prominent among Distributors, respondents from the Southern United States, Non-Energy states, and those with more than $25 million dollars in revenue.

A score of 75 to 99 represents more cautious or measured optimism. A score below 75 signals that fewer executives say local construction activity will increase than say it will decrease, a more pessimistic point of view.

The OQ for 2020 is on par with past years showing more caution ahead of expected political and regulatory uncertainty. An OQ score of 99 still represents optimism for increased local construction activity relative to the perceived level of activity for the prior calendar year.

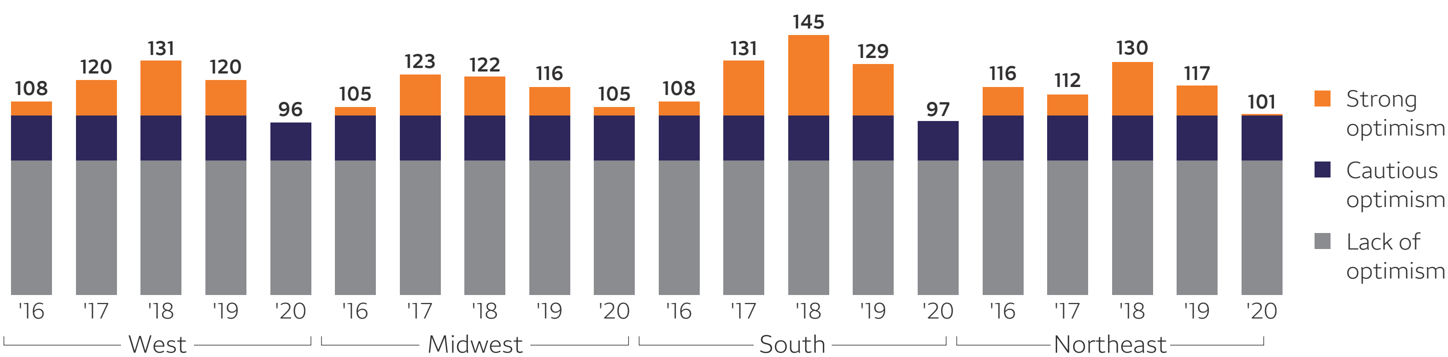
U.S. National Optimism Quotient



Base: Total respondents – 305 in 2020, 441 in 2019, 312 in 2018, 407 in 2017, 474 in 2016, 413 in 2015, 552 in 2014, 370 in 2013, 405 in 2012.

Local nonresidential construction enters cautious optimism in 2020 with a score of 99, trending down from the record high reached in 2018. The Optimism Quotient (OQ) presented by Wells Fargo Equipment Finance is this survey's primary metric for assessing respondents' sentiment about local nonresidential construction activity. The measurement is directional in nature and gives an indication of industry executives' optimism about the coming year compared to the previous year.

U.S. National Optimism Quotient by region



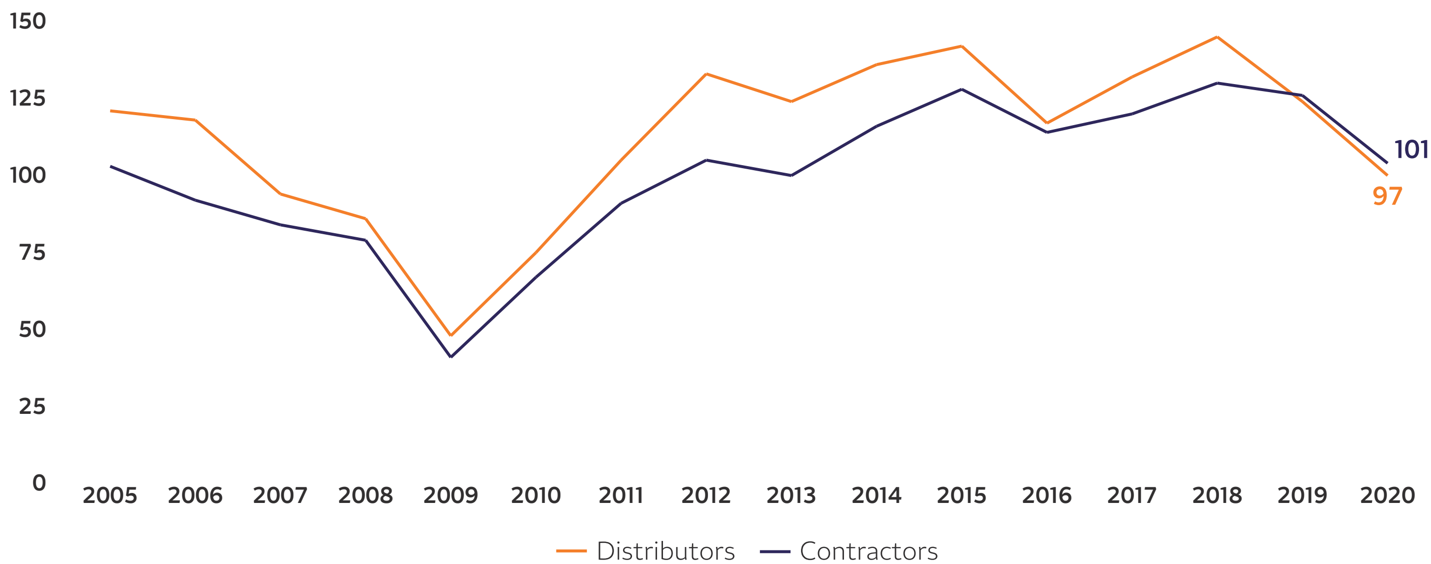
Base: Total respondents.

Optimism is fairly strong, but declined across all regions compared to 2019 continuing a downward trend from a record high in 2018. The largest decrease came from the South where the respondents feel less optimistic about local nonresidential construction activity in 2020, again consistent with a similar decline from last year.

Optimism gap has shifted

Distributors and contractors have slightly differing opinions in 2020 regarding optimism. Overall, optimism decreased among both distributors and contractors. Notably, contractors indicate a higher level of optimism. Historically, distributors have expressed higher optimism than contractors, but for 2020, distributors' optimism decreases from 121 to 97 into cautious optimism while contractors remain categorized as strongly optimistic with a score of 101 (though still a decline from 123 in 2019).

Distributors and Contractors U.S. National Optimism Quotient



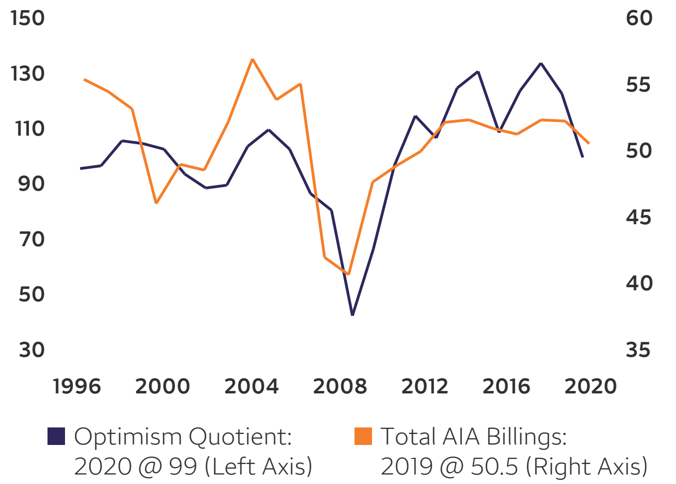
Base: Total 2020 contractors (n=166), distributors and rental companies (n=102), equipment manufacturers (n=21^), and other (n=16^). ^Small base size

Editor's note: Beginning with the 2014 survey, we have calculated the OQ for distributors using the combined responses of those that identified themselves as distributors or as equipment rental companies. In prior years, we did not combine the two categories.

How does Optimism Quotient compare to other key economic indices?

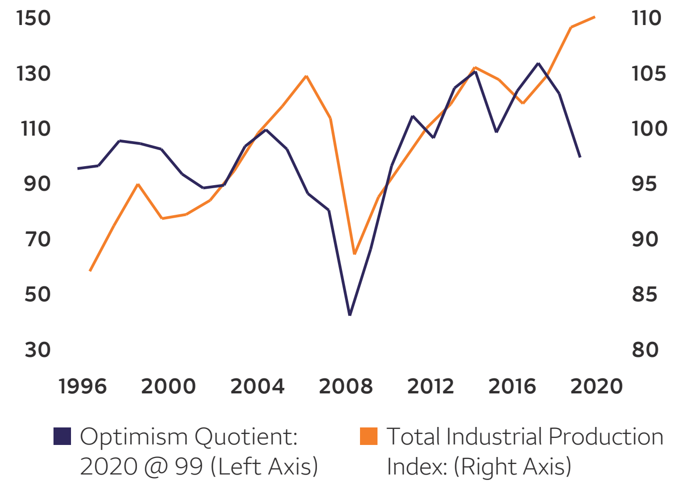
Four economic indices that are significant to the construction industry outlook are the Architectural Billings Index, the Private Construction Index, the Industrial Production Index, and the Public Nonresidential Construction Index. Although there are outlier years, the overall data over time shows that the Optimism Quotient tracks closely with these economic indices.

Optimism Quotient vs. Total Architectural Billing Index



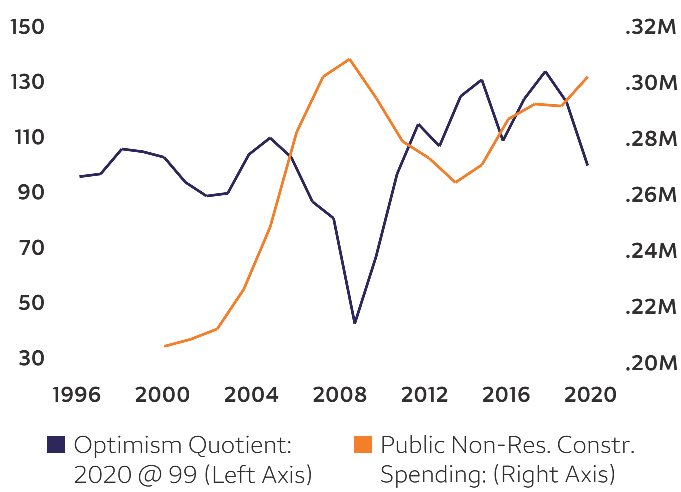
Source: The American Institute of Architects (AIA)

Optimism Quotient vs. Industrial Production Index



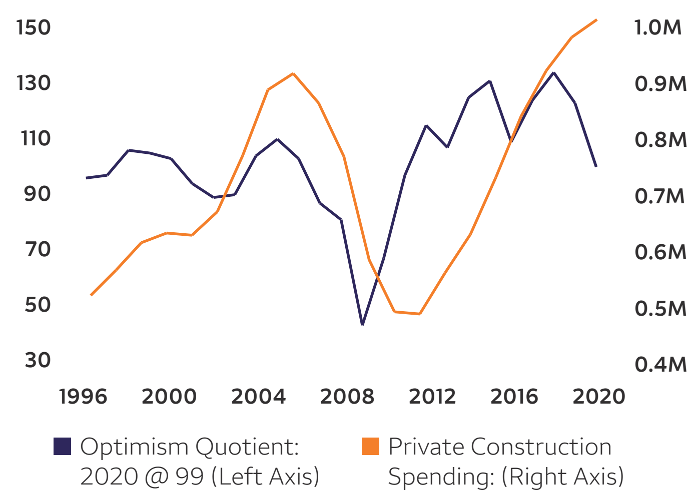
Source: Wells Fargo Securities, LLC.

Optimism Quotient vs. Public Nonresidential Construction Index



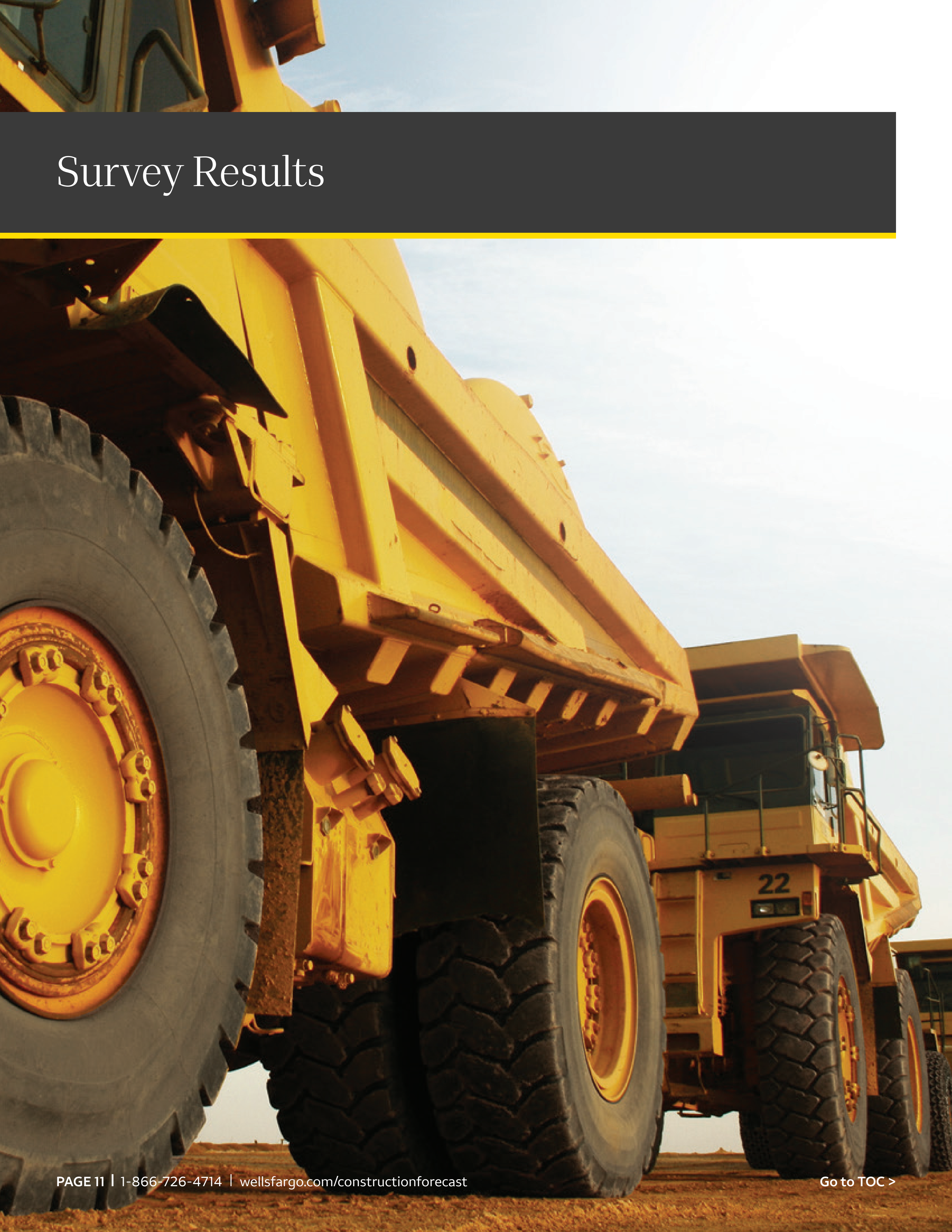
Source: U.S. Census Bureau (BOC): Construction Put-In-Place (C30)

Optimism Quotient vs. Private Construction Index, billions of dollars



Source: U.S. Census Bureau (BOC): Construction Put-In-Place (C30)

Survey Results



The top four learnings for 2020

1. Industry Optimism

Contractors and distributors together are cautiously optimistic (99) about construction activity in 2020. Contractors (101) are optimistic about construction activity while distributors are more cautious (97). Overall, 2020 represents a year of cautious optimism on par with tempered sentiments expressed in previous election years.

2. Equipment Acquisition

In 2020, distributors and contractors expect sales and purchases of used equipment will remain the same shifting away from expected increases last year. Distributors are more mixed in their expectations indicating sales of new equipment will remain the same or increase, though those expecting their sales will decrease has risen since last year. Similarly, 73% of contractors believe their purchases of new equipment will remain the same, if not increase. Consistent with 2019, a stronger backlog of jobs and long-term confidence in the local economy are the top two key factors that would encourage the purchase of construction equipment.

3. Top Cost Concerns

While distributors' apprehensions are roughly equal among the top four concerns, 54% of contractors agreed that the ability to hire and retain skilled labor was the #1 concern. Distributors primarily worry about equipment costs and equipment rental costs followed closely by employee wages and other benefits and healthcare costs. The primary concern among contractors for 2020 continues to be the ability to hire qualified workers, ranked above the impact of employee wages and benefits, material costs, healthcare costs, interest rates, and the cost of equipment.

4. Top Industry Risks

Executives say that political/regulatory uncertainty (35%), availability of qualified workers (25%), and economic uncertainty (21%) are the leading factors that pose the greatest risks to the construction industry in 2020. Unsurprising in an election year, the uncertainty over the outcome of the election and its potential impact on the industry is a common concern among executives with 90% indicating that the 2020 election will have somewhat (43%) or a great deal (47%) of impact on the industry. Consistent with past election years, this also hinders executives' willingness to be optimistic about the construction industry.

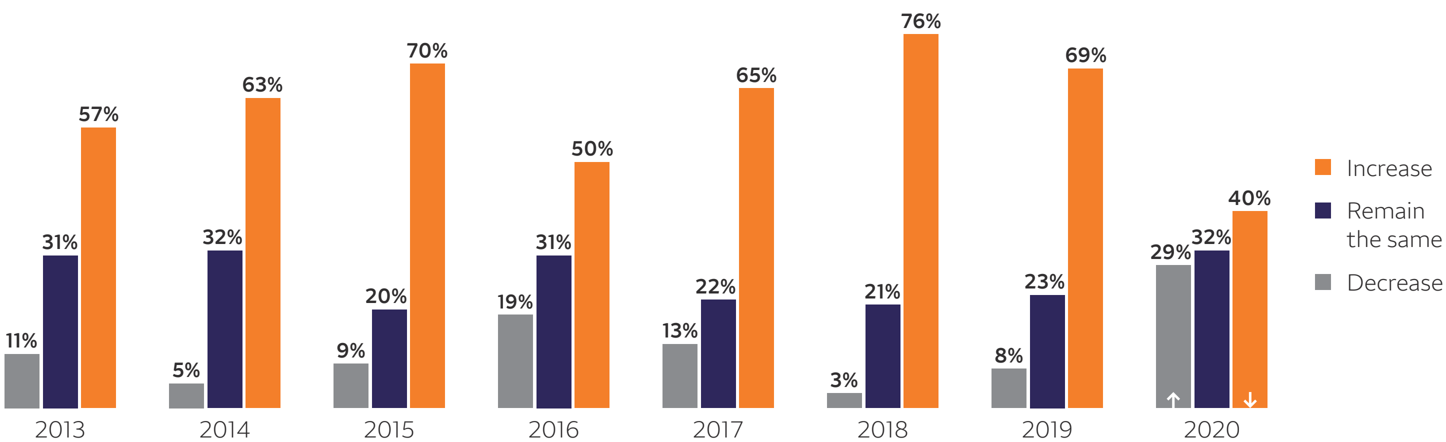
Go to TOC >

How do industry executives feel in 2020

Distributors

Distributors continue to be generally optimistic regarding future sales of new construction equipment. Just under two-thirds of distributor respondents expect new equipment sales to increase; a lower expectation than last year with sentiments shifting toward expecting sales to remain the same. Significantly more distributors expect to see a decrease in new equipment sales in 2020 than in 2019 continuing a trend from last year.

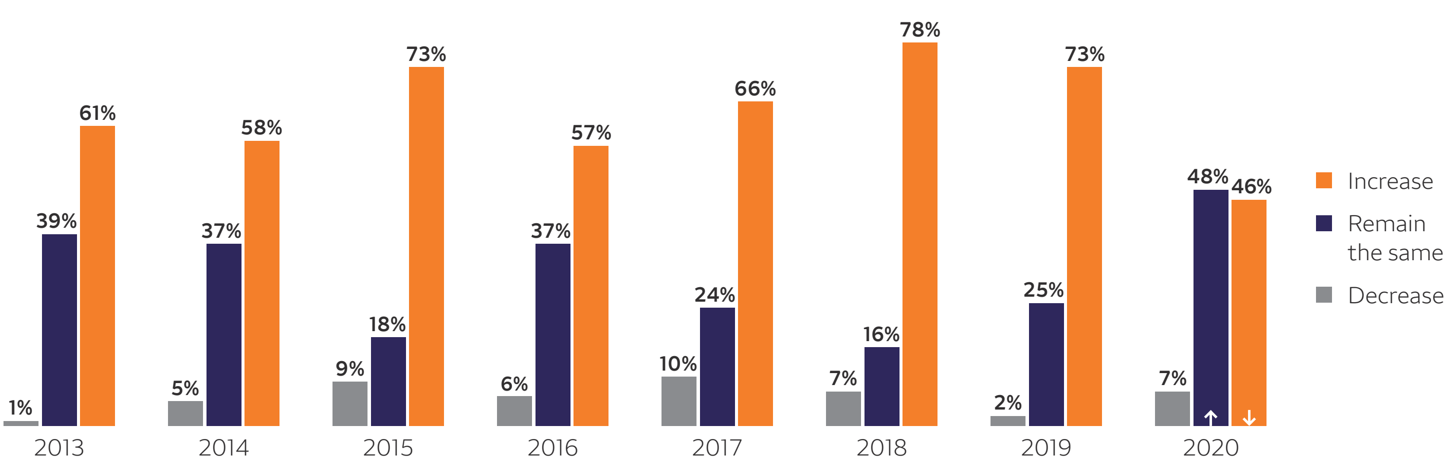
Do you think that your sales of new construction equipment this year compared to last year will:



Base: Total distributors and rental companies answering: 98 in 2020, 124 in 2019, 102 in 2018, 130 in 2017, 162 in 2016, 132 in 2015.

Distributors are still forecasting strong sales for used construction equipment in 2020. Executives who reported that they think sales of used construction equipment will increase in 2020 declined significantly from 73% to 46% with expectations shifting to predict sales of used equipment will remain the same. Distributors who believe their sales of used equipment in 2020 will decrease is statistically on par with 2019.

Do you think that your sales of used construction equipment this year compared to last year will:

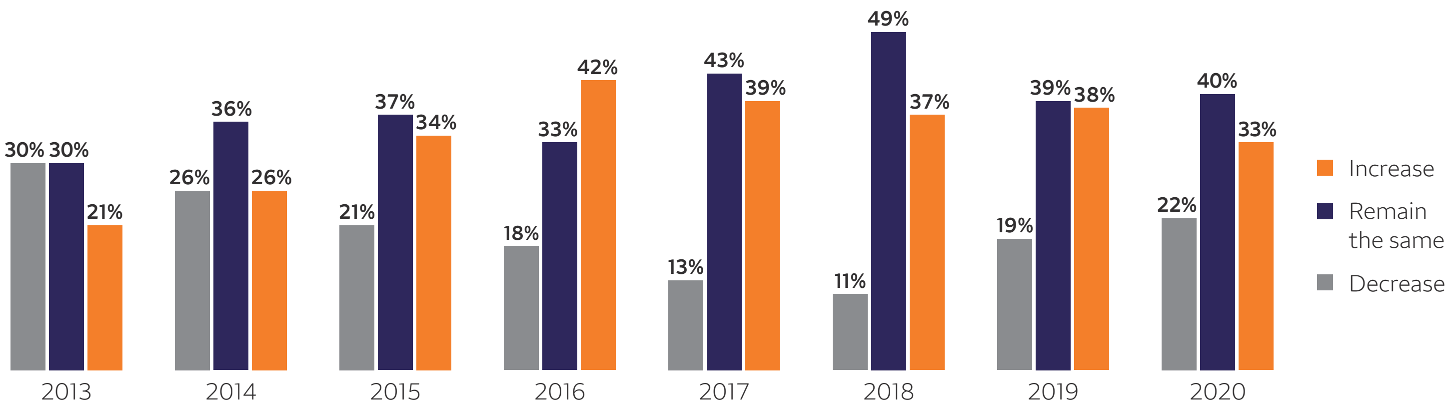


The up/down arrows denote a significant difference from 2019 at the 95% confidence level.
Base: Total distributors and rental companies answering: 101 in 2020, 124 in 2019, 103 in 2018, 134 in 2017, 167 in 2016, 132 in 2015.

Contractors

Contractors opinions about their purchases of new equipment in 2020 is consistent with 2019. Just over one-third of contractor respondents believe new equipment purchases will increase this year and about 4 in 10 expect new equipment purchases to remain flat. On par with 2019, 22% of contractors expect to see a decrease in new equipment purchases in 2020.

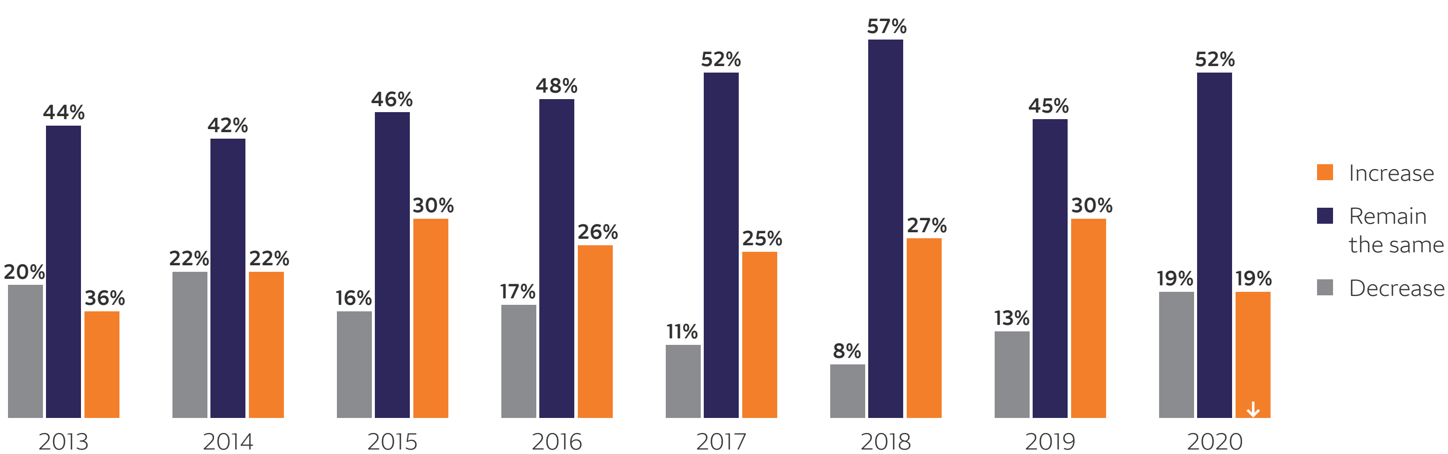
Do you think that your purchases of new construction equipment this year compared to last year will:



Note: The up/down arrows denote a significant difference compared to 2019 at the 95% confidence level.
Base: Total contractors – 166 in 2020, 262 in 2019, 150 in 2018, 194 in 2017, 248 in 2016, 238 in 2015.

Most contractors expect their purchase of used equipment will remain the same or increase; however, their estimates are more conservative than last year with over half expecting purchases to remain the same. Those who predict purchases of used equipment will increase (19%) is down from 2019 (30%).

Do you think that your purchases of used construction equipment this year compared to last year will:

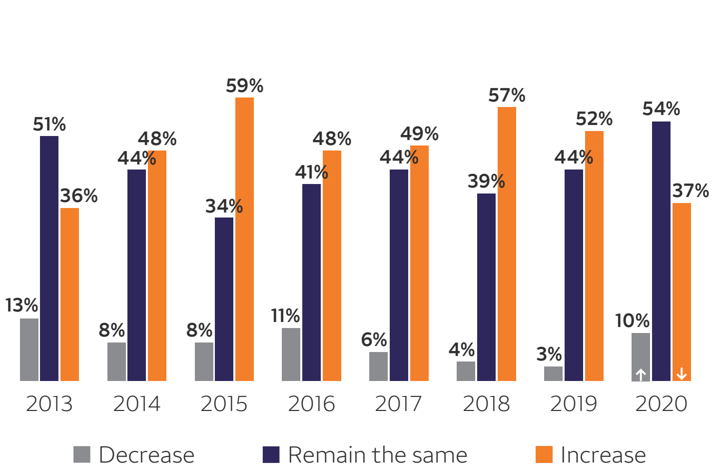


Note: The up/down arrows denote a significant difference compared to 2019 at the 95% confidence level.
Base: Total contractors – 166 in 2020, 262 in 2019, 150 in 2018, 194 in 2017, 248 in 2016, 238 in 2015.

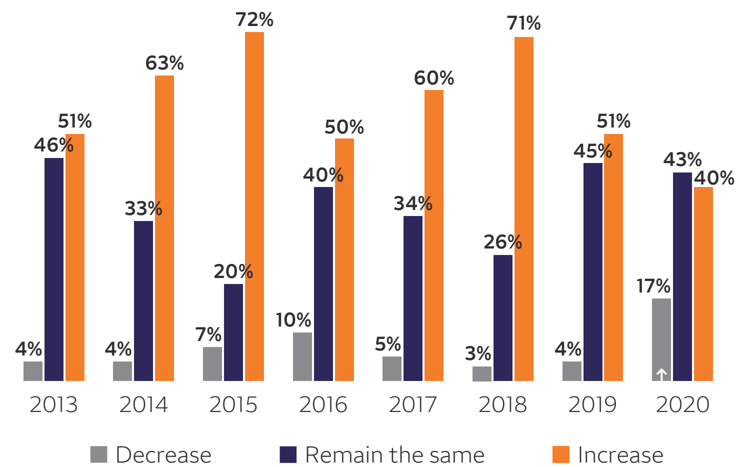
How do industry executives feel in 2020

Nonresidential Construction

Contractors — What is your projection for local nonresidential construction activity this year compared to last year?



Distributors — What is your projection for local nonresidential construction activity for this year compared to last year?

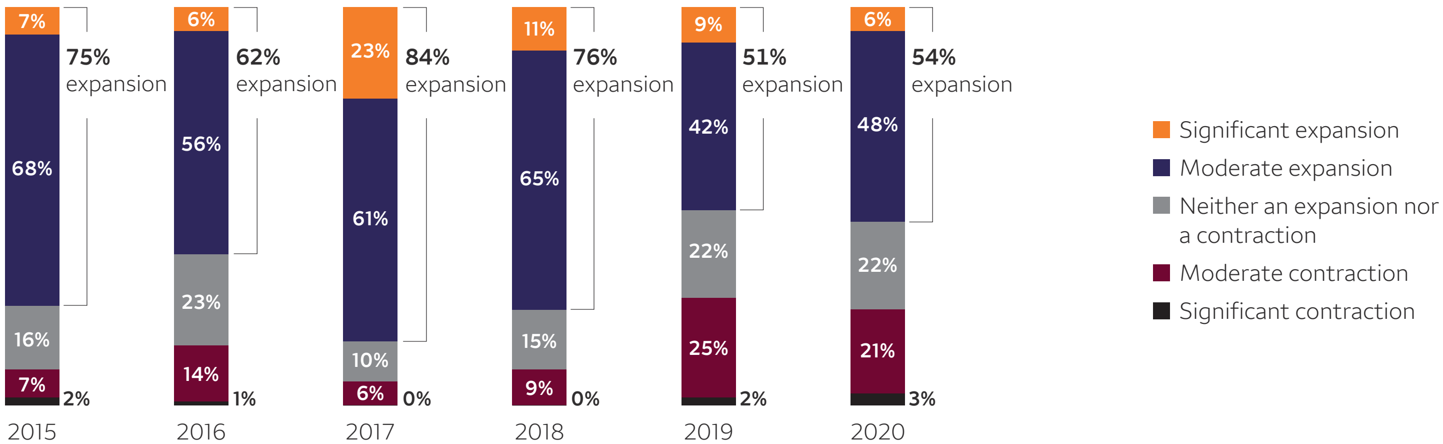


Note: The up/down arrows denote a significant difference compared to 2019 at the 95% confidence level.
Base: Total contractors – 166 in 2020, 262 in 2019, 150 in 2018, 194 in 2017, 248 in 2016, 238 in 2015.
Base: Total distributors and rental companies answering: 101 in 2020, 124 in 2019, 103 in 2018, 134 in 2017, 167 in 2016, 132 in 2015.

The increase in those who believe nonresidential construction activity will decline is roughly equal among contractors and distributors. Among distributors, 17% predict a decline compared to 4% in 2019. Similarly, 10% of contractors expect a decrease in activity in 2020 compared to 3%, though this is not as drastic as the distributors' expectations. Distributors are more mixed in their predictions, while contractors are more likely to believe activity will remain the same.

Industry growth

Two years from now, which of the following scenarios is most likely to occur?



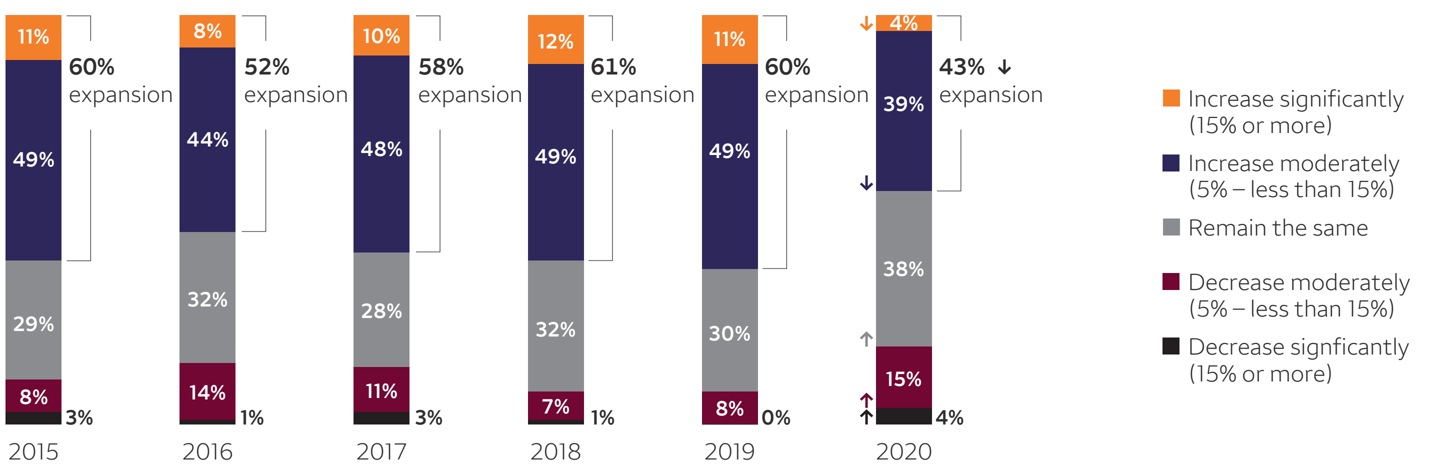
Up/down arrows denote a significant difference from 2019 at the 95% confidence level.
Base: Total respondents – 305 in 2020, 441 in 2019, 312 in 2018, 407 in 2017, 474 in 2016

Perceptions of industry growth over the next two years is on par with 2019 with 54% expecting expansion (either significant or moderate). Those who believe the industry will contract over the next two years is also unchanged from 2019.

What about its bearing on net profits?

Net profits

Compared to net profits for 2019, do you think your net profits in 2020 will:



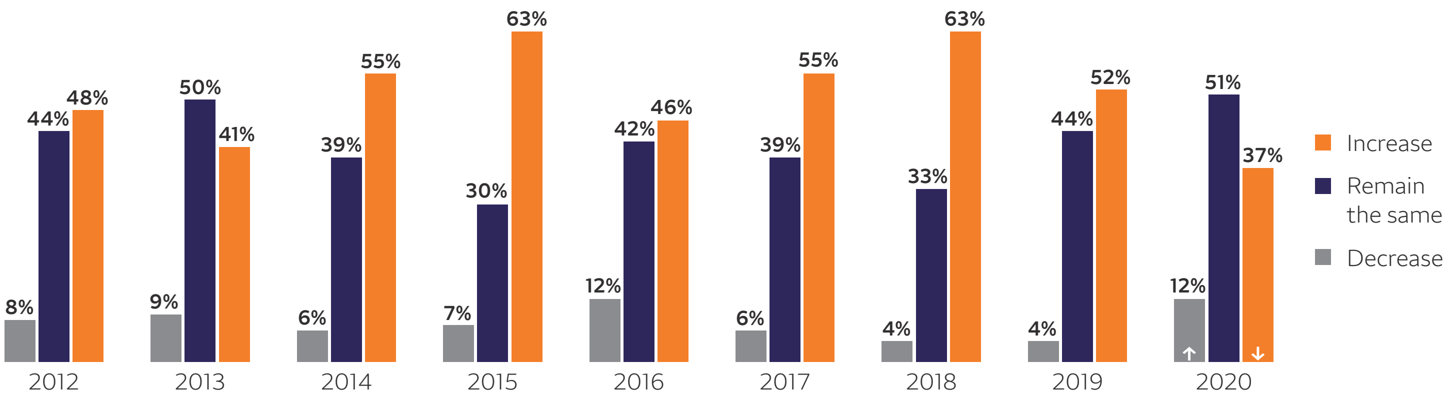
Up/down arrows denote a significant difference from 2019 at the 95% confidence level.
Base: Total respondents – 305 in 2020, 441 in 2019, 312 in 2018, 407 in 2017, 474 in 2016.

Almost half of executives remain positive about profitability in 2020, though the number expecting an increase in profits has gone down significantly compared to 2019. 81% feel profitability is going to be the same, or better than last year. Though predictions are largely positive, the number expecting profits to decrease has jumped in 2020 to 19% from 8% in 2019.

Nonresidential vs. Residential activity

In 2020, executives shift toward a more tempered forecast for local **nonresidential** activity as only 37% expect an increase in activity compared to 52% in 2019. There is also a larger number predicting a decrease in activity (12%) in 2020 compared to 2019 (4%). The shift in perception of nonresidential activity in 2020 is most evident among non-energy states, the South region, and influencers and larger companies with more than $25M in revenue. Among those who expect nonresidential activity to remain constant, two-thirds (67%) believe improvement will happen in 2021 or beyond.

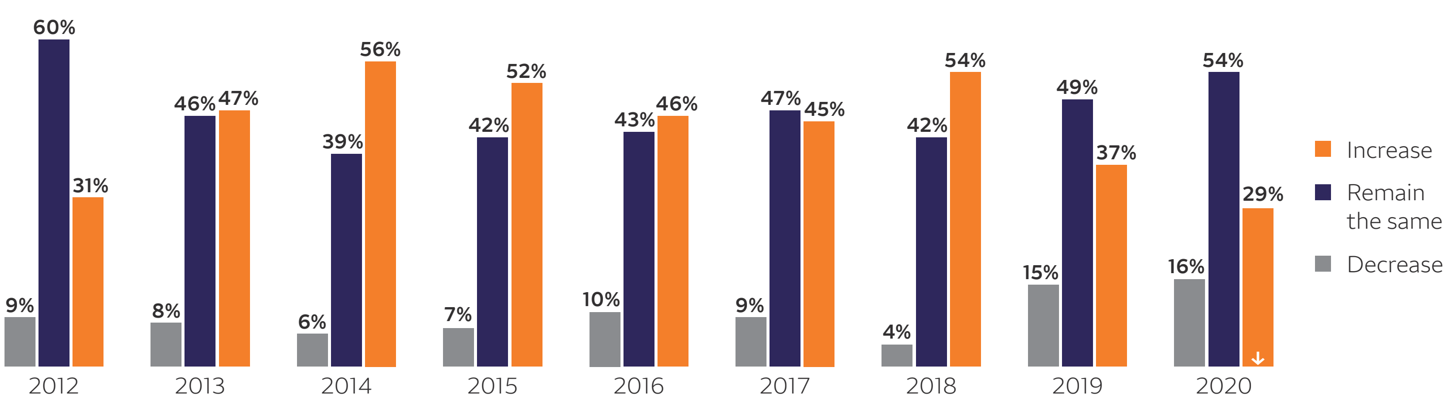
What is your projection for local nonresidential construction activity in 2020 compared to 2019?



The up/down arrows denote a significant difference compared to 2019 at the 95% confidence level.
Base: Total respondents – 305 in 2020, 441 in 2019, 312 in 2018, 407 in 2017, 474 in 2016.

For local residential construction in 2020, over half believe that activity will remain the same as last year. Compared to 2019, fewer executives expect an increase in activity. In 2020, only 29% of respondents expect an increase in residential construction activity, while in 2019, 37% expected to see an increase, dropping significantly for the second year in a row. There is a shift trending toward those who believe local residential construction will remain the same (54% in 2020 vs. 37% in 2019). Consistent with nonresidential activity, over half of executives who believe activity will remain the same predict that improvement to residential construction activity will begin improving in 2021 or beyond.

What is your projection for local residential construction activity in 2020 compared to 2019?



The up/down arrows denote a significant difference from 2018 at the 95% confidence level.
Base: Total contractors – 262 in 2019, 150 in 2018, 194 in 2017, 248 in 2016.

Thinking about the state of your business, what short-term concerns do you have?

"Our short-term concerns are finding qualified employees for our open positions, the continuing rise in health care costs, the litigious environment in which businesses have to operate in, and borrowing costs."

— **SURVEY RESPONDENT**

Construction Industry Overview

What's ahead for Construction in 2020?

This Year's 2% Growth Will Feel Better Than Last Year's 2%

After slowing from nearly 3% growth in 2018, real GDP looks to have risen just slightly more than 2% this past year. Most of the moderation has come from capital spending, with reduced oil and gas exploration accounting for a large proportion of the slowing in nonresidential construction outlays and the lingering uncertainty about tariffs stifling outlays on capital equipment. With Phase 1 of a trade deal with China signed as well as a revamped NAFTA (which is now the USMCA), we expect the fog of uncertainty surrounding international trade to gradually lift over the course of 2020. Global growth looks set to accelerate this year, although the coronavirus and Boeing's production cuts of 737 MAX assemblies will likely weigh heavily on first quarter growth.

While 2020 is likely to get off to a slow start, we expect momentum to gradually build over the course of the year. The Federal Reserve cut interest rates three times this past year by a total of 75 basis points. Long-term yields also declined, with the yield on the 10-year Treasury falling 77 basis points. Yields have fallen further at the start of 2020, mostly on fears that efforts to contain the coronavirus will lead to a sharp slowing in global economic growth. Even if yields rebound from current levels, as we expect them to, the drop in rates that we saw last year will likely boost economic growth this spring and summer. Monetary policy works with a long and variable lag, with the bulk of the lift from a drop in interest rates boosting the economy somewhere between 12 and 18 months later.

Lower interest rates should provide construction a much needed boost. While parts of commercial construction have been strong for some time — primarily luxury/lifestyle apartments, warehouse and distribution space, hotels, and Central Business District (CBD) office space in a handful of rapidly growing cities — the overall volume of commercial construction has lagged considerably behind prior cycles. The weakness has mostly been in the suburbs — particularly retail space and office parks that tend to cluster around shopping malls and interstate highways. The past decade saw a move back toward the center cities, particularly by younger workers.

A Shift Back to the Suburbs

The urban migration fueled a building boom in mid-rise and high-rise luxury/lifestyle apartments and also drove redevelopment of neighborhoods that were closer to the key employment markets. Tear downs and rebuilds accounted for a substantial proportion of single-family construction during the past decade and that process required much less additional infrastructure investment. The renewed interest in downtown areas also sparked the redevelopment of former retail and industrial spaces into new office space. Both trends are expected to continue in the coming decade but we are also seeing momentum building for more greenfield development in the suburbs.

The shift back to the suburbs is likely to build over the course of the decade, as more and more millennials reach their forties and begin to focus on raising a family. The move back to the suburbs is not likely to mimic what was seen in the post-World War II era, however, which was driven by an affordability migration that followed the ever-expanding highway network further and further out into the suburbs and exurbs. We expect a larger proportion of millennials to remain closer to the center cities than prior generations did and look for the suburbs to increasingly urbanize, adding entertainment, healthcare, and other amenities found closer to downtown areas.

Suburban residential development is set for stronger growth. We see single-family homebuilding gradually gaining momentum over the course of the decade, as the preference for single-family living gradually reverts back to its long-term norm. Single-family housing starts totaled 888,200 units this past year and we expect starts to gradually rise to around 1.1 million units by the end of the decade. Multi-family starts are expected to remain near their recent pace, although we expect to see a shift toward more condominium development over the course of the decade. In addition, many of the luxury and lifestyle apartments were built with the idea that they might one day be converted to for-sale housing, which would fuel growth in renovations.

For the near-term, we are looking for homebuilding to be a key source of strength in 2020. Sales of new homes rose 10.3% this past year and likely would have risen even more if not for the lack of supply in rapidly growing markets in the South and West. The strength in sales has bolstered builder confidence and we are seeing increased residential development in rapidly growing areas in the South and West. The South has accounted for close to 56% of single-family starts, with the bulk of the activity occurring in Texas and Florida.

Demand for homes in the South continues to be driven by population and employment growth, as well as the region's greater affordability. Eight of the nation's 10 fastest growing major metropolitan areas from 2010 to 2018 were in the South. The median price of a new home is about 10% less in the South than it is nationwide, more than 28% less than it is in the West and whopping 39% less than the Northeast. We look for single-family housing starts to rise 7% in 2020 and 2.1% in 2021. Multi-family starts will likely remain near recent levels, although a late-year surge in starts in 2019 may set the stage for a slightly smaller number of starts this year.

The revival in suburban residential development should provide some relief to retail development, with most of the growth in neighborhood centers and a handful of regional shopping centers. On an overall basis, however, the U.S. is still considerably overstored and we expect retail construction to decline 3.5% in 2020, following a larger 6.4% drop in 2019. We have a small 1.3% rise projected for 2021. Retailers continue to struggle with competition from online sales, which are capturing close to half the growth in retail sales each year. While overall retail development will remain soft, redevelopment activity remains a growth area, with former retail space being repurposed into mixed-use projects, healthcare facilities, fulfillment centers, and educational facilities.

The flip side of the weakness in retail development has been persistent strong growth in industrial development. Growth is being fueled by three overriding trends: The growing need for fulfillment centers that provide the last mile of e-commerce, the development of larger regional distribution centers, and growing volumes of international trade. The latter influence is being felt at all of the nation's major ports but is most apparent in rapidly growing ports in the Southeast, which have seen a growing share of container traffic shift from the West Coast following the widening of the Panama Canal. Southern ports have also added key infrastructure to move containers rapidly onto trucks and, increasingly, trains which link the ports to key inland areas. The Southeast has also seen considerable foreign direct investment in manufacturing facilities, many of which serve as key export platforms.

Office development rose solidly this past year, with office construction outlays rising 7.9% following an 8.4% gain the prior year. Much of the growth has been in markets where the tech sector is growing rapidly, such as San Francisco, Seattle, Los Angeles, Dallas-Fort Worth, Austin, and Denver. Growth has also picked up along the East Coast, particularly in rapidly growing areas such as Atlanta, Nashville, Charlotte, Raleigh, and Northern Virginia. Most new office projects continue to be in the CBD or near-in urban submarkets. Returns on suburban office space have generally lagged, which has opened up fairly sizable gap in rental rates between downtown areas and the suburbs. We look for demand to revive in the suburbs over the course of the decade and look for office development to gradually increase as more suburban areas seek ways to urbanize and capture some of the energy prevalent in many downtown areas.

Hotel development is one of the great mysteries of this past decade. New hotel construction has soared past expectations, as demand has proven strong. Hotel operators are struggling with slow revenue per available room (RevPAR) growth, which is expected to eventually slow

Go to TOC >

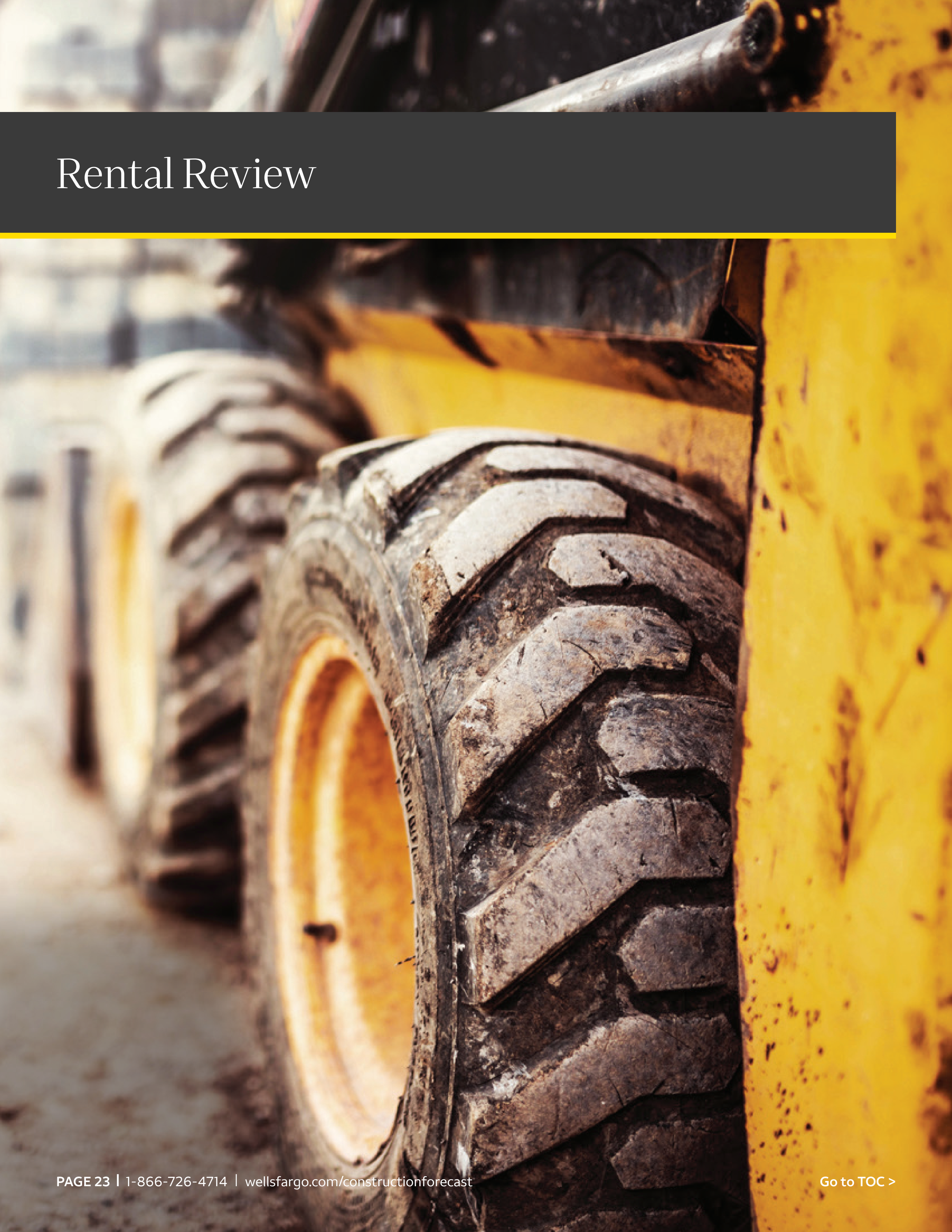
construction. We do not think the slowdown will be this year, however, and look for hotel construction to rise 4.5%, following an 8.2% rise the prior year.

Growth in institutional projects is expected to remain strong, reflecting stronger state and local government revenue growth and the demands of an aging population. Spending for healthcare, education, and public safety will account for the bulk of the 4.2% rise in outlays we are expecting in 2020. Amusement and recreation is another growth area, although construction is expected to slow from the double-digit gains seen this past decade. While the category is relatively small, it benefits from the rising number of Baby Boomers retiring each year, as well as the strong preference of Millennials to live near key entertainment hubs.

Overall, we look for nonresidential construction spending to rise 2.8% in 2020, which would be a slight improvement over the 2.3% gain posted this past year. With more greenfield development, we should see more spending on road work and water and sewer projects as well. The bulk of new construction will continue to be in the Sun Belt. We are seeing a shift away from some of the larger markets on the West Coast toward midsized and smaller markets in the West, as well as an out-migration to Texas and the Southeast. The Northeast is also seeing an accelerated migration, fueled by Baby Boomers and prime working-age individuals seeking lower taxes and more affordable housing.

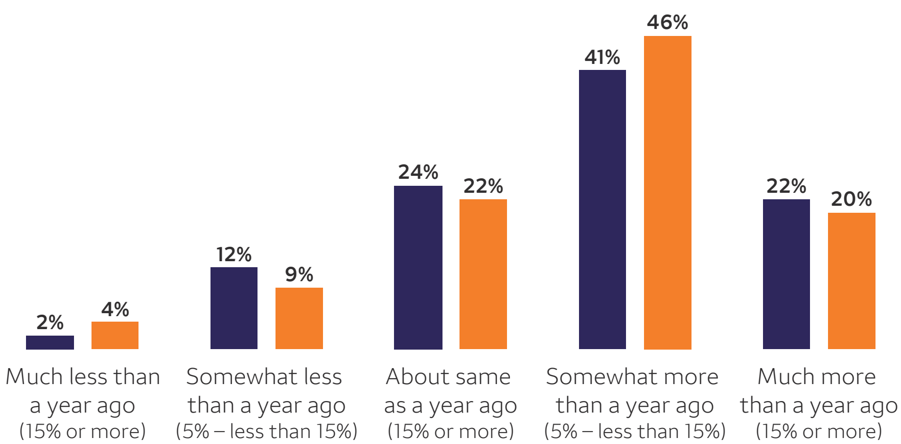
Mark Vitner
Managing Director and
Senior Economist
Wells Fargo Securities, LLC

Rental Review



Nearly 8 in 10 contractors feel that they will rent the same or more equipment as last year and predict purchases of new and used equipment will largely remain the same as last year as well. With no statistical differences from 2019, the majority of distributors are renting out more construction equipment now than a year ago and almost half do not plan to increase their rental prices.

(Distributors and rental companies) Compared to a year ago, how much construction equipment are you now renting out to contractors?



Note: No data previous to 2018 is shown due to changes to Q20b in 2018.
Base: Total distributors and rental companies: 102 in 2020, 127 in 2019.

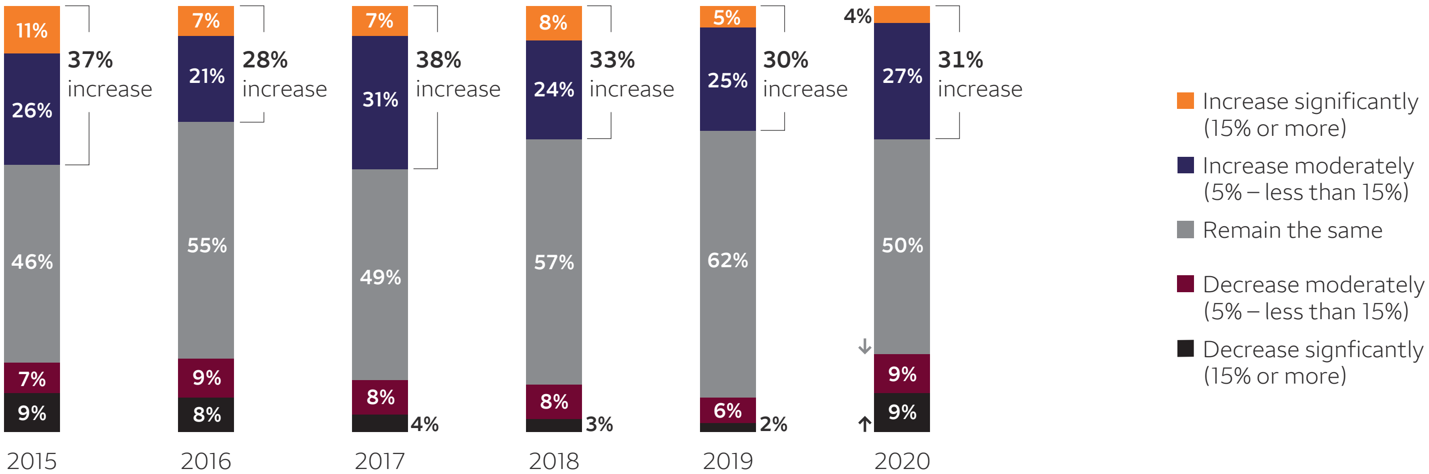
Most distributors are using 60% to 79% of their rental fleets, though those using 70% to less than 80% has increased significantly (28% in 2020 vs. 17% in 2019).

What one thing could your financial services provider do to help your business be more successful in 2020?

"Offer low finance rates and project unwavering support of the construction industry."

— **SURVEY RESPONDENT**

(Contractors who rented equipment) Do you think that your rental of heavy construction equipment this year compared to last year will:



The up/down arrows denote a significant difference compared to 2019 at the 95% confidence level. Base: Contractors who rented heavy construction equipment in 2019: 139 in 2020, 204 in 2019, 119 in 2018, 155 in 2017, 208 in 2016, 189 in 2015.

Half of contractors who rent heavy equipment still think their renting behaviors will not change, with 50% indicating their rental practices will remain the same in 2020, though this is down significantly from 2019 (62%). There is a statistical increase in those who predict their rentals will decrease significantly (9% in 2020 vs. 2% in 2019). 31% of contractors are planning to increase or increase significantly in 2020 as long as rental prices remain fair.

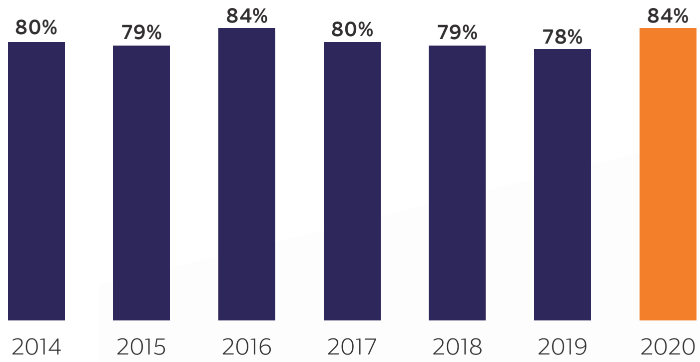
(Contractors) Why do you rent construction equipment? Please rank the top three.

Top reason % (Ranked 1st)	2018	2019	2020
Flexibility; I can return equipment whenever I want	51%	46%	49%
Rental equipment is readily available	23%	19%	23%
Build equity before purchase	9%	20%	11% ↓
I don't want to own/acquire eqiupment	9%	6%	9%
High costs to repair and maintain my own fleet	5%	5%	5%
Rental rates are low and attractive	4%	5%	3%

The up/down arrows denote a significant difference compared to 2019 at the 95% confidence level.
Base: Total contractors: 166 in 2020, 262 in 2019, 150 in 2018.

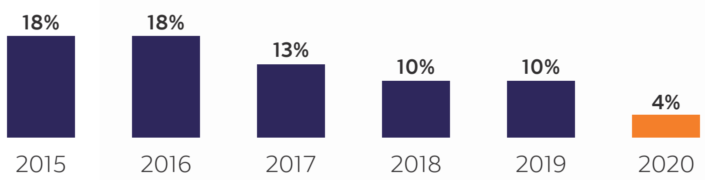
As in past years, flexibility remains the key factor in the decision to rent equipment. There is a shift back to levels on par with 2018 in those who indicate building equity before purchasing is an important reason for renting equipment (11% in 2020 compared to 20% in 2019 and 9% in 2018). The most common duration for the rental period is monthly.

(Contractors) Did your company rent any heavy construction equipment in 2019? (% – Yes)



Rental of heavy construction equipment remains strong and on par with previous years. A large majority (84%) of contractors rented heavy construction equipment in 2019. Of those who did not rent in 2019, only 4% predict they will rent in 2020.

(Contractors who did not rent heavy construction equipment in 2019) Do you think that you will rent heavy construction equipment in 2020? (% – Yes)



Base: Contractors that did not rent any heavy construction equipment last year – 27^ in 2020, 58 in 2019, 31^ in 2018, 39^ in 2017, 40^ in 2016. ^Small base size

Go to TOC >

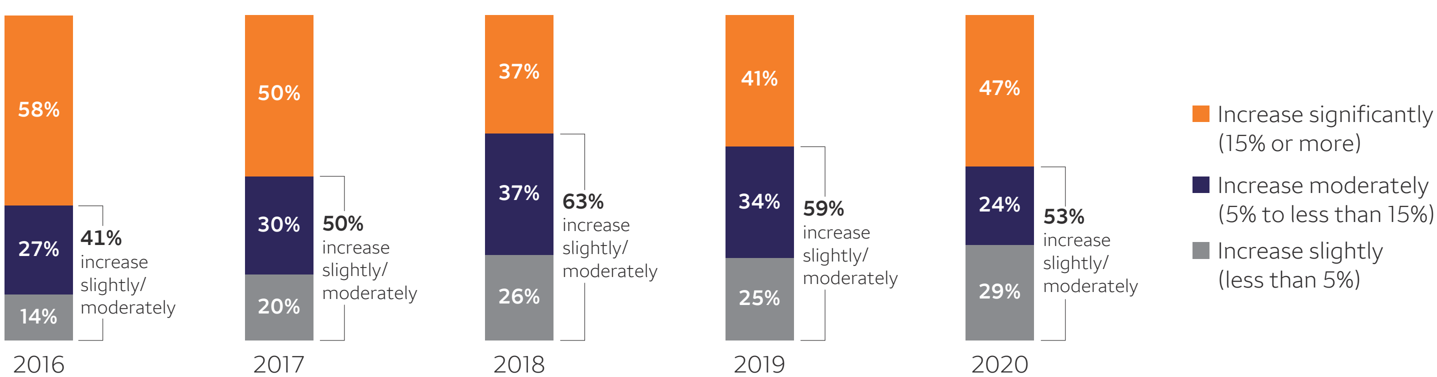
(Contractors) What would you need to happen for you to want to buy construction equipment?

	2019	2020	
Stronger backlog of jobs	22%	24%	
Long-term confidence in the local economy	22%	23%	
Long-term confidence in the national economy	9%	15%	↑
Special low rate interest programs	10%	11%	
Passing of a long-term highway funding bill	7%	9%	
Ability to hire workers to operate the equipment	12%	8%	
Lower equipment costs	9%	5%	
My company would not consider buying construction equipment in 2020	3%	2%	
Ability to hire workers to operate the equipment	6%	2%	↓

Note: No data previous to 2019 is shown due to changes to Q11a in 2018.
Base: Total contractors: 166 in 2020, 262 in 2019.

As in 2019, a stronger backlog of jobs and long-term confidence in the local/national economy are the key factors that would encourage purchases of construction equipment over renting. Long-term confidence in the national economy saw a statistical increase in 2020 (15%) compared to 2019 (9%). Other indicators that may spur purchases instead of rentals would be special low interest rate programs, the passing of a long-term highway funding bill, and the ability to hire qualified workers.

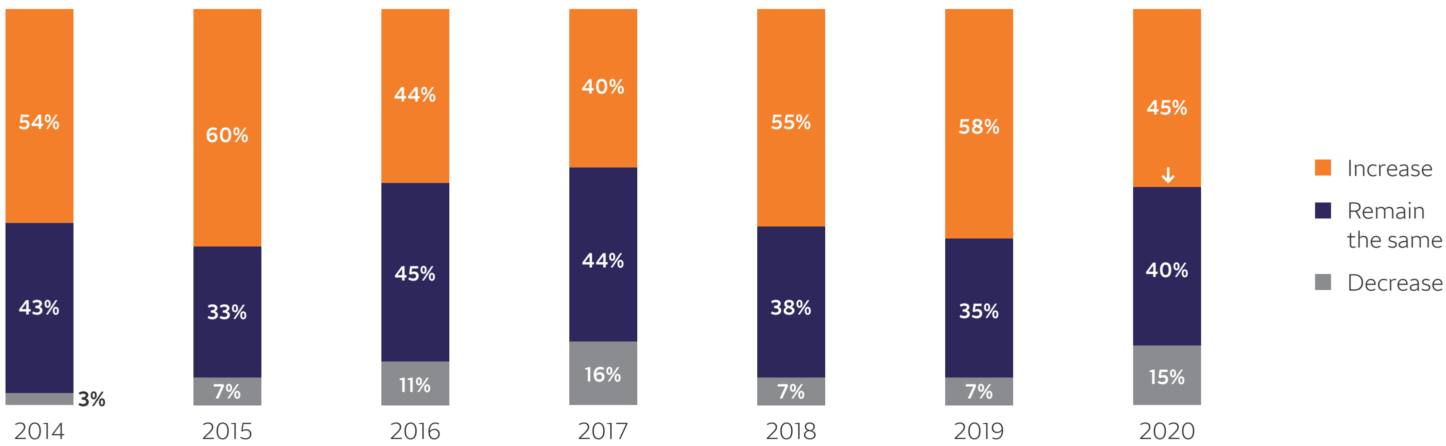
(Contractors) How much would construction equipment rental costs need to increase for you to consider buying instead of renting equipment?



53% of contractors indicate that rental costs would only need to increase slightly (less than 5%) or moderately (5% to 15%) for them to consider buying instead of renting equipment.

Base: Contractors whose company would consider buying construction equipment: 155 in 2020, 244 in 2019, 147 in 2018, 187 in 2017, 228 in 2016.

(Distributors) Do you think that the size of your rental fleet this year compared to last year will:



Base: Total distributors and rental companies: 102 in 2020; 127 in 2019; 105 in 2018; 134 in 2017; 174 in 2016; 138 in 2015; 175 in 2014

In 2020, distributors expect the size of their rental fleet will increase or remain the same. Distributors who believe their rental fleet will increase, specifically, has gone down significantly compared to 2019 (45% in 2020 vs. 58% in 2019). While statistically on par, 15% of distributors expect to decrease rental fleet sizes, up from 7% in 2019. This continues to be a good sign for contractors who plan to supplement their fleet size with rentals.

What important changes do you believe will occur in the construction industry over the next two years?

"Presidential and congressional election will have a major effect on the industry in the next two years. Promises of increased infrastructure spending has been in the works; depending on which parties control the funding will determine the growth."

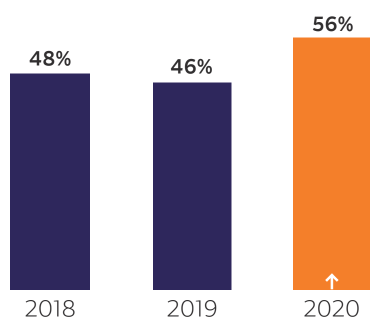
— **SURVEY RESPONDENT**

Risk, Regulations, and Opportunities

Accounting changes: Are you aware?

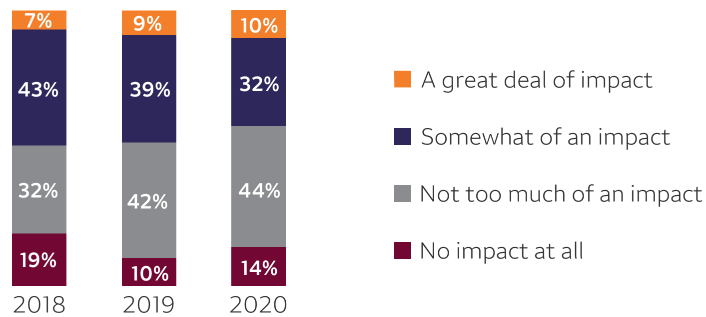
Awareness of pending changes to accounting rules about leasing has increased in 2020 to 56% from 46% in 2019. Though, over half believe it will have little to no impact on their business, expectations are split with approximately 4 in 10 indicating the changes could have an impact (somewhat or a great deal). The concern over this impact from the pending changes to accounting rules for leasing is relatively minimal, with 64% being "slightly" or "not at all concerned".

Awareness of pending changes to accounting rules relating to leasing (% – Yes)



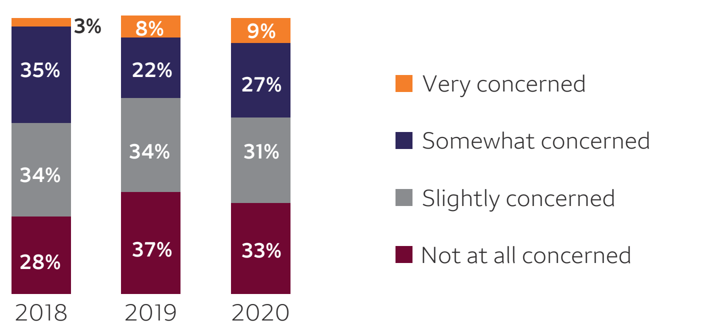
Base: Total respondents: 305 in 2020, 441 in 2019, 312 in 2018.

What impact will the pending changes to accounting rules for leasing have on your business?



Base: Respondents who were aware of the pending changes to accounting rules relating to leasing – 171 in 2020, 204 in 2019, 149 in 2018.

How concerned are you about the impact the pending changes to accounting rules for leasing will have on your business?



Base: Respondents who were aware of the pending changes to accounting rules relating to leasing – 171 in 2020, 204 in 2019, 149 in 2018.

Which of these factors poses the greatest risk to the U.S. construction industry in 2020?

Top answer % (Ranked 1st)	2020
Political/regulatory uncertainty	35%
Availability of qualified workers	25%
Economic uncertainty	21%
Tariffs	4%
Rising material costs	3%
Declining residential construction market	3%
Fluctuating interest rates	2%
Declining nonresidential construction market	2%
Weather	2%
Energy prices such as oil and natural gas	1%
Other	1%

Note: No previous data is shown due to changes to Q26. Q26aa was added to the survey in 2020, no previous data are available to present. Base: Total respondents: 305 in 2020.

Unsurprisingly for an election year, political/regulatory uncertainty is considered the greatest risk to the industry in 2020. The next factor executives believe is a great risk to the construction industry is the availability of qualified workers with 25% ranking it as the single greatest risk. Economic uncertainty remains a top concern for one in five respondents as well.

Which of these factors creates the greatest opportunity for growth in the U.S. construction industry next year?

Top answer % (Ranked 1st)	2020
Improved political climate	22%
Improved qualified labor availability	15%
Improved natural economic situation	12%
Increased government spending	10%
Improved local economic situation	10%
Improving nonresidential construction market	9%
Stable regulatory environment	7%
Increased consumer confidence	6%
Improving residential construction market	5%
Improved financial condition of state and local agencies	5%
Other	1%

Note: No previous data is shown due to changes to Q27 in 2020.
Base: Total respondents: 305 in 2020.

Executives cite an improved political climate (22%), improved qualified labor availability (15%), and improved national economic situation (12%) as the greatest opportunities for growth in the construction industry. Increased government spending (10%) and an improved local economic situation (10%) are also top factors that executives believe would lead toward improvement.

Which of the following regulatory issues is of greatest interest to you as it relates to the success of your company? (please rank the top three)

Top answer % (Ranked 1st)	2020
Highway Funding Bill	41%
Tax reforms/tax incentives	24%
Oil prices	11%
Tariffs	10%
Affordable Care Act	6%
Gas tax	3%
Debt ceiling	3%
Other	3%

Note: no previous data is shown due to changes in Q30 in 2020.
Base: 305 in 2020.

In 2020, the Highway Funding Bill (41%) is considered the greatest regulatory issue of interest followed by Tax reforms/incentives (24%). Oil prices and tariffs are also of great interest for 1 in 10 respondents.

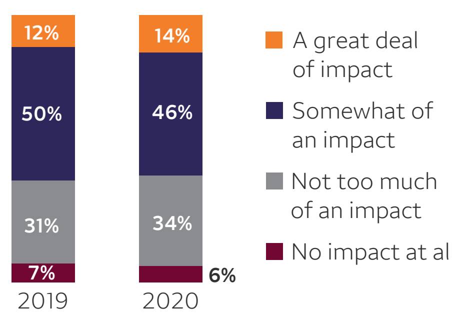
Impact on business: Tax reform, tariffs, interest rates, and weather

Similar to 2019, tax reform, changing tariffs, and changing interest rates are expected to have somewhat to a great deal of impact on businesses. In 2020, the number predicting that interest rates will have a great deal of impact has gone down (22% in 2020 vs. 29% in 2019), expectations have tempered with significantly more executives forecasting little to no impact (28% in 2020 vs. 14% in 2019).

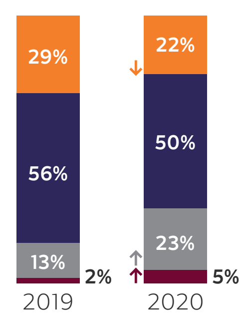
The weather had a mixed impact on businesses in 2019 with some executives mentioning the bad weather helped business while others described negative outcomes. Overall, 61% of executives said weather affected their business in 2019.

What impact, if any, do the following have on your business in 2020?

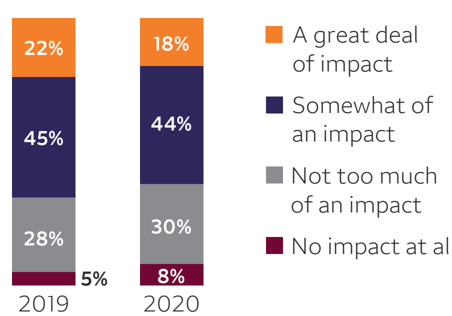
Changing tariffs



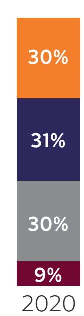
Changing interest rates



Tax reform



Weather



Note. Q30g was added in 2020; no previous data are available to present. The up/down arrows denote a significant difference compared to 2019 at the 95% confidence level. Base: Total respondents: 305 in 2020, 441 in 2019.

Business Strategy

Ranking concerns of contractors and distributors

The ability to hire qualified workers (54%) and employee wages and other benefits (13%) ranked as contractors' top cost concerns for the second year in a row. Distributors list four areas of almost equal concern: Equipment costs (25%), equipment rental costs — cost of carrying rental fleet (23%), employee wages and other benefits (21%), and healthcare costs (20%). Notably, financing costs for distributors dropped back to levels on par with past years following a spike in 2019.

(Contractors) Of the following cost categories, which three concern you the most? Please rank the top three.

	2019	2020
Ability to hire qualified workers	47%	54%
Employee wages and other benefits	11%	13%
Equipment purchase costs	7%	8%
Materials costs	8%	5%
Healthcare costs	10%	4% ↓
Interest rates	6%	4%
Taxes	5%	4%
Fuel costs	5%	4%
Equipment rental costs	*	1%
Other	1%	1%

*Total responses amount to less than 1%
The up/down arrows denote a significant difference compared to 2019 at the 95% confidence level. Base: Total contractors: 166 in 2020, 262 in 2019.

(Distributors) Of the following cost categories, which three concern you the most? Please rank the top three.

Top concern % (Ranked 1st)	2015	2016	2017	2018	2019	2020
Equipment costs	29%	24%	31%	20%	26%	25%
Equipment rental costs — cost of carrying rental fleet	15%	21%	19%	20%	14%	23%
Employee wages and other benefits	9%	17%	10%	19%	22%	21%
Healthcare costs	28%	21%	22%	18%	11%	20%
Financing costs	7%	7%	10%	8%	23%	7% ↓
Taxes	12%	10%	7%	15%	4%	6%

The up/down arrows denote a significant difference compared to 2019 at the 95% confidence level.
Base: Total distributors and rental companies: 102 in 2020, 127 in 2019, 105 in 2018, 134 in 2017, 174 in 2016, 138 in 2015.

Explain why you said the weather impacted your business.

"Rain through June delayed many projects. With the lack of qualified staff, contractors couldn't make up for the lost time."

— **SURVEY RESPONDENT**

What important changes do you believe will occur in the construction industry over the next two years?

"Ongoing increase in productivity due to innovations in equipment. Increased lack of skilled work force."

— **SURVEY RESPONDENT**

What short-term concerns do you have?

"Keeping our backlog full and have no lag time between profitable projects."

— **SURVEY RESPONDENT**

What one thing could your financial services provider do to help your business be more successful in 2020?

"Provide insight and knowledge of industry wide purchasing trends and practices."

— **SURVEY RESPONDENT**

Go to TOC >

About Us

Wells Fargo Equipment Finance (WFEF)

Wells Fargo Equipment Finance provides businesses nationwide with competitive fixed- and floating-rate loans and leases that cover a full range of commercial equipment, floor planning, and inventory financing. We have industry financing specialists dedicated to construction, energy, commercial and specialty vehicles, marine, rail, aircraft, and vendor financing programs.

We offer a broad range of direct and vendor finance programs for equipment end-users, distributors, and manufacturers in the United States and Canada. Wells Fargo Equipment Finance is a leading bank-affiliated equipment leasing and finance provider in the U.S. and Canada, with more than $46 billion in assets under management, more than 300,000 customers, and 2,500 team members.[1]

Construction equipment financing

We have deep experience in the construction industry and offer tailored financing and leasing solutions. Our nationwide coverage allows us to connect our customers with the correct products to help meet their financial needs and WFEF offers complete, flexible financial solutions for the entire industry. With end-user leases and loans, dealer retail referral programs, dealer rental fleet and floorplan financing, and manufacturer subsidized retail and inventory programs, we have products suited to your particular needs.

To learn more: call **1-866-726-4714** or visit **wellsfargo.com/constructionforecast**

1. Company data as of February 2020.