

Life Advanced
Markets

TARGET MARKETING:

Construction Industry

2021: 3Q - 4Q

CONSTRUCTION

Industry The North American Industry Classification System (NAICS) classifies companies in the construction industry into three broad categories:

- Building Construction (residential and nonresidential)
- Heavy and Civil Engineering (infrastructure)
- Specialty Trades (industrial-specific)

Trends and concerns for the companies that engage in these areas also affect – to varying degrees – companies in other related industries, such as material and tool suppliers (manufacturing), architects, and engineers (professional services).

Trends The existing supply of houses is 4.4 months as of April 2021, down from a high of 12.2 months in January 2009, and the lowest supply since the summer of 2003.¹ Low housing supply will increase demand for residential construction. More than \$1 trillion in spending was recently proposed in Congress relevant to the construction industry, primarily in new and modernized infrastructure, with a substantial amount for affordable housing and public architecture.² Revenue expectations for the next 12 months improved in 1Q 2021, with 36% of contractors expecting their revenue to increase – up from 25% of contractors anticipating more revenue last quarter.³

Concerns Davis-Bacon and Related Acts (DBRA) requires contractors to pay **prevailing wage (e.g., union) rates** for all federally funded contracts, even if the contracted labor is non-unionized (87.3% of construction workforce⁴). Recent executive orders direct **strict enforcement** of these provisions.⁵

80% of contractors continue to experience COVID-19 related **project delays** in 1Q 2021, down 3 points since last quarter.⁶

Most contractors (71%) continue to experience at least one **product shortage**, steady from last quarter. Concerns over wood/lumber shortages are easing, down to 22% of contractors (from 31% last quarter⁷).

35% of contractors say **steel and aluminum tariffs** will have a high to very-high impact over the next three years – up sharply from 24% last quarter.

Finding skilled workers remains a challenge for contractors in 1Q 2021 – 85% agree, up from 83% last quarter.

46% of contractors report a high degree of concern about their workers having an **adequate skill level**, up 10% from 4Q 2020. And 46% of contractors plan on hiring workers over the next six months, up from 32% a year ago – which will increase competition for workers.⁸

34% of contractors report **turning down work due to labor shortages**, a decrease from 39% last quarter.⁹

Contractors appear to be hiring less-qualified workers in order to meet ongoing demand.



¹ Monthly Supply of Houses in the United States (MSACSR), Federal Reserve Bank of St. Louis, <https://fred.stlouisfed.org/series/MSACSR>.

² Fact Sheet: The American Jobs Plan, 3/31/21, <https://www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan/>.

^{3,6,9} U.S. Chamber of Commerce Commercial Construction Index Q1 2021, https://www.uschamber.com/sites/default/files/cci_2021_q1_report.pdf.

⁴ United States Department of Labor, Bureau of Labor Statistics.

⁵ Buy American executive order.

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ISSUE

OPPORTUNITY

Obtaining surety bonds is a consistent key issue in the construction industry. Government projects require them, as will almost any major private contract.

Review buy-sell agreement and funding: Surety providers want to see a well-developed and maintained business continuation plan.

Informally funded NQDC/SERP: Surety providers are also looking for low debt-to-asset ratios. Life insurance cash surrender value may be included in the surety providers' definition of "working capital," which is a key factor in obtaining a surety bond.

Key person life insurance: Surety companies will want to have a sufficient level of comfort that the death of the owner, or other key person, won't cause financial stress to the business such that it risks their ability to complete projects.

With current low inventories and high demand, home builders will have opportunities that may provide substantial revenue, profit, and valuation increases in the coming years.

Life Insurance as a Financial EngineSM: Potential increases in tax rates and the loss of existing tax advantages mean business owners should be evaluating tax-efficient options as well as basis-shifting strategies.

A broadly improving construction marketplace – especially with an infrastructure deal – means other construction businesses will see a similar increase in revenue, profit, and valuation. Interest in mergers & acquisitions may increase.

Business continuation bonus plan: Retaining key employees through ownership transition is vital.

There are significant ongoing concerns about finding and retaining workers with adequate skills to satisfactorily complete available work.

Key employee compensation strategies: Evaluate HR options for attracting and retaining skilled employees.

Evaluate creditor protection strategies: Being forced to rely on less-skilled workers raises liability concerns. Assets outside the business with creditor protection advantages may be appealing.

Life insurance death benefit is generally income-tax-free when passed on to beneficiaries.

Fixed index universal life insurance requires qualification through health and financial underwriting.

ADDITIONAL TALKING POINTS / PLANNING OPPORTUNITIES:

- **Construction companies that are family-owned businesses present a number of business succession opportunities.** When multiple children are the intended successors, but they have different skill sets and aptitude, the business may be better suited for operating as separate units than other forms of businesses. Construction companies are often made up of three different parts: 1) business operations (e.g., contracts, finances, project management, etc.); 2) equipment owned to complete the projects; and 3) the land on which the business operates (e.g., equipment storage, office space, etc.). The owner may divide the business into separate business entities, execute long-term contracts between the separate entities, then gift or sell the separate entities to their children. This may have a number of tax and non-tax advantages.
- **We may be in a period where revenue for construction companies has been lower over the past year, but may increase substantially in the years ahead** as tariffs are eliminated, government spending on infrastructure increases, supply chains rebound, and labor shortages are addressed. This creates an opportunity to transfer business interests to family members at lower valuations. For example, if the business interest is valued based on the three-year average EBITDA, and the past year had an unusually low EBITDA, an owner could gift or sell an interest with a justifiably low value.
 - Family business succession planning presents numerous life insurance opportunities, such as amending and funding buy-sell agreements, new key employee life insurance, business continuation bonus plans for key employees, etc.
- **Construction companies, and the many businesses that support them, may experience a shift in demand** for the type of projects available and the way they conduct business.
 - 1) Political efforts are being made to substantially increase spending on “green” construction projects. According to the Global Alliance for Buildings and Construction, 28% of global CO2 emissions come from building operations, and another 11% come from building materials and construction. This has caused a global push toward more energy efficient construction practices, net zero carbon buildings, and other efforts that could present challenges and opportunities for the construction sector.
 - 2) The COVID-19 pandemic may change demand for the types of projects available to construction companies. Demand is expected to increase for warehousing, life science facilities, data centers, etc., but possibly decrease for office space and retail space. These changes may be temporary or long term.
 - In order to take advantage of these new opportunities, construction companies will need strong human resources talent, project managers with experience in new markets, and other talent the business may not currently have under their roof. This presents opportunities to discuss key employee compensation strategies, such as bonus plans, split-dollar, and nonqualified deferred compensation.

RESOURCES: Click these links to learn more.

- National Association of Homebuilders
- Associated General Contractors of America
- Associated Builders and Contractors, Inc.



To learn more, contact the Advanced Sales and Practice Platform team at 800.800.3220 or AdvancedStrategies@allianzlife.com

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