Good morning, everybody. Dennis Engelbrecht, Digging Deeper.

Today, I want to talk about reading the tea leaves. What is going to happen with the construction industry? Is there going to be growth ahead? Is there going to be an economic recession? What's going to happen in our markets? What do we do about it? All of those sorts of things. I know this is a subject we talked about before, but really, I wanted to give you the tools to be able to do this in your organization to better read those tea leaves. Recently, construction, commercial and institutional construction, really has been on a tear, at least in terms of dollars spent, construction put in place. Last year we had growth of roughly 8%. This year we're up in the 17, 18% area. I mean, construction is with an economy that people think is teetering, we're just killing it in this business. We're doing absolutely great currently.

But what's going to happen in the future and what does the future hold? Well, to understand that for your organization, we're going to talk about several things. We're going to talk about the national indicators, talk a little bit about FBI's own index, talk about public funding, talk about some of the headwinds out there, and then talk about some of the local sector and customer effects you might have because one of the things about construction, these numbers I'm talking about, these are national numbers. So, this is what's happening across a broad spectrum of the economy. But this isn't necessarily what's happening in Nebraska or in Michigan or in Florida or in Wichita, Kansas or wherever you are. It may be a little bit different. So, we want to talk, first of all, from a national standpoint. There are a number of very good indicators out there that have been very reliable over the years.

Most of these national indicators are seven to 12 months in advance, what's going to happen in the next seven to 12 months, and there's a variation in these indicators for how far out they actually reach. But the ones I use and the ones I recommend you using are the ABC backlog index that basically shows how much backlog subcontractors have on their books over time, and that tends to vary from about six months up to 10 months, and that's been relatively strong here throughout the recent years and is still running pretty strong and pretty steady. The Architects Association, the AIA billing index, which also comes out monthly, that measures the extent to which architects and engineers are signing new business and getting new contracts and ultimately billing. And this billing index basically kind of forecasts what you're going to put in place out there again, 10 to 12 months out in the future.

The Dodge Construction Network has their momentum index and also a starts index. The momentum index reaches out a little further because it's actually at when items first hit the design phase. That's also been operating as a very high level, which most of these are at high level because we've had high growth in the industry. And then their starts, which that means when the construction actually begins on these large projects, that gets measured in their starts index, which has also been strong.

And then Construct Connect and other organization also creates a start index and measures that. So, among those five things, those are five good national indicators. What you're seeing now from each of those, while they're all at very strong levels, they've all sort of steadied out and that's steadying out kind of indicates that construction is not going to continue growing at the pace it is growing, but it's going to start to steady out now as we move into the future.

At FBI, we created an index which looks 12 to 24 months out in advance. And of course, anytime you get further out in advance, the certainty of how that's going to play out may not be quite as strong, but it has proven so far to be pretty effective. Now we look at residential construction and residential permits. We look at employment and over time we look at interest rates, construction price inputs, the yield curve, durable good sales and what's happening in REITs. And so, we put all of that together in an index and that sort of forecast 12 to 24 months out into the future. What that's telling us right now is that while we're in this current growth phase and it's expected to continue growing for the next several months, is really as we hit the 12 months out from now, we're going to be back in either a slight decline or really just the very steadying out. As you look out 12 to 24 months, it looks like we're just going to sort of steady out with the possibility of some slight contraction in construction spending.

Public funding is a big aspect for construction and it's kind of hard to capture in terms of a specific indicator, but right now, state, and local income tax, property tax, sales and specialty taxes, these have all been growing really for the last 12 years at a very good pace. When we came out of the great recession, a lot of these coffers were very low, so there was some tightness and some pullbacks in construction spending. But right now, most of the coffers are pretty full for that.

In addition to that, of course there was a lot of pandemic recovery money in the big bills passed by the government that went directly to construction businesses and a lot of other businesses, but also into supporting construction, both for infrastructure as well as private construction when it comes to chips and things like that, that new technologies and a lot of support for that, and it's billions and billions of dollars.

So, there is a lot of public funding and support. All of that is pretty much is at a high. Again, there's only been one bad quarter really in tax revenue collection, and that was the quarter following the start of the pandemic itself when we lost a lot of gas tax and things like that as people really cut back in that very quick recession. But outside of that, these have all been growing and all look very good. So public spending for construction should be very strong into at least the next three to five years.

Now there are headwinds out there and you should pay attention to the headwinds because if those hit, they could definitely kind of put the brakes on for construction spending. Those headwinds are higher interest rates, if interest rates continue to go up or stay up even where they currently are, that is a sort of a break on private investment and the economy in general, the consumer and everyone else from that standpoint. With our recent shutdown, if you've read much into that, there is movement again for reduced government spending because we have these high budget deficits and there's a certain sector that was trying to get some commitments to reduce that government spending in order to continue to fund the government.

High inflation. We seem to be getting the better of inflation, but again, underlying the energy prices are very high and are possibly at risk to continue going up. So that's a big risk. And oil spikes have been the cause of some recessions in the past.

We have some increasing vacancy rates on various groups of real estate, especially office real estate, and there still are question marks coming out of the pandemic, the extent to which some companies are going to be using their space. So that of course affects investment in future office warehouse. Right now, multifamily is still holding up pretty well, but there is rent retrenchment in some markets, and again, if rents go down and interest rates go up, that makes the investment in those properties not as good as it has been. So, you're seeing some reduction in planning in that sector right now.

So basically, if you look at all of this, all indicators are sort of in agreement and the agreement is basically that, all right, we're in this growth phase, maybe going to last for the next three to nine months or so, and then we're going to go into very much a stagnant phase for construction, at least in what we can foresee over the next, maybe starting by midyear next year, on through the following year and possibly beyond. It doesn't look like anything major's going to happen. Again, you got to keep your eye on those headwinds.

And then equally important for each of you out there, if you're trying to read your tea leaves, all of these things we talked about are national sort of indicators. So, you do need to look at what's happening locally in the sectors that you service or your primary sectors that you're involved in, and even the individual customers that you serve. Because if repeat customers account for maybe 30, 40% of your business or even as much as 60% of your business, what those individual companies are doing is going to have a big effect on you. And depending on what happens in the economy and the swings from one sector or another, certainly those things could be affecting you. So, keep your eyes on what's happening in your local economy, what's happening in the particular sectors you work in, and watch your individual customers and look for their announcements and their future, what they're planning to do.

So, if you combine all of this information, then really what do you do with it? Well, you go back into planning mode. Are we planning for high growth? Are we planning for steady? And I think as a leader, there's always uncertainty. So, you want to keep a steady hand on the wheel. You don't want to be jerking back and forth and your organization doesn't know what you're planning for. So right now, things look relatively good for the near future and solid for the long-term future because we've had all of this growth and we have a tightness in our labor markets and skilled markets. It's hard to grow and maybe a sort of retrenchment where we have a year or two where there's not as much growth, it could possibly be positive for the industry and positive for your business.

So that's how you look at the tea leaves, at least from my perspective. Dennis Engelbrecht, Digging Deeper.