CONSTRUCTION OUTLOOK 2023

Dodge Construction Network

Introduction

New dangers are facing U.S. economic growth in 2023 as the Federal Reserve manufactures a slowdown to ease the growth in inflation. With construction often on the leading edge of economic growth, this move brings meaningful threats to the construction industry and its members.

In this report, **Dodge Data and Analytics**, North America's leading provider of data and analytics for the construction industry, uses proprietary data, econometric modeling, and experienced insights to create a fact-based and grounded national outlook for the construction industry.

Economic Outlook

- Economic growth is slowing considerably, given the Federal Reserve's aggressive increases in interest rates. In 2023, Dodge predicts that U.S. economic growth will slow to just 0.7%, bringing the economy dangerously close to recession.

- Higher material prices and continued labor shortages will remain a drag on the construction sector and will further dampen growth in the coming year.

Rapidly rising inflation (stemming largely from COVID-19 supply-chain disruptions and exacerbated by Russia's invasion of Ukraine) has prompted the Federal Reserve to aggressively hike interest rates. As interest rates have risen, the near-term outlook for the economy and therefore construction have become much more tenuous. After climbing an estimated 17% in 2022, construction starts are expected to flatten in 2023 at $1.083 trillion.

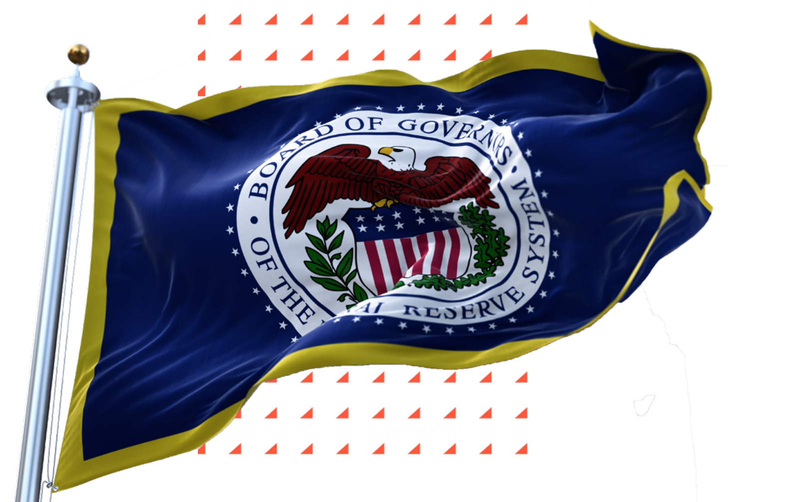
› The Federal Reserve raised rates six times in 2022 bringing the target rate to its highest level **(3.75-4.0%)** since early 2008.

Not all sectors will be equally affected: nonresidential building starts will slide a pronounced 10% to $375 billion, residential starts will remain unchanged in 2023 at $427 billion, and nonbuilding starts will buck the downward trend with a 16% increase to $281 billion.

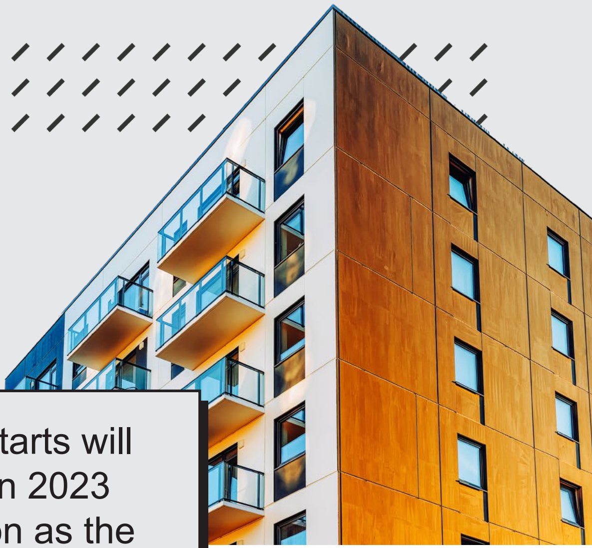
Dodge currently expects the economy to narrowly avoid recession in 2023, but odds of a successful soft landing are narrowing. Greater-than-normal economic volatility and a less certain construction outlook will persist in the new year, although the primary reason has shifted from the COVID-19 pandemic to the Federal Reserve's decision to aggressively battle inflation. Multiple and steep interest rate hikes in 2022 and into 2023 will mean significantly slower economic growth in 2023 and weaker performance for the major drivers of construction starts.

With supply chains yet to return to normal, construction materials prices will also remain elevated in 2023.

And although inflation pressures will begin to abate, uncertainty will continue to affect future construction decision-making, presenting a major risk for the outlook. On the positive side, nonbuilding construction will be more insulated from economic turmoil than other sectors by the recent passage of several federal legislative efforts to fund and support U.S. infrastructure rehabilitation and development. At the same time, the often-broken Congressional appropriations process could pose problems for the nonbuilding sector if it delays distribution of infrastructure funding.



Residential Buildings



-6%

› Single family construction is already on the decline and will flatten at $274 billion in 2023 as the number of units falls 6% to 891,000.

+1%

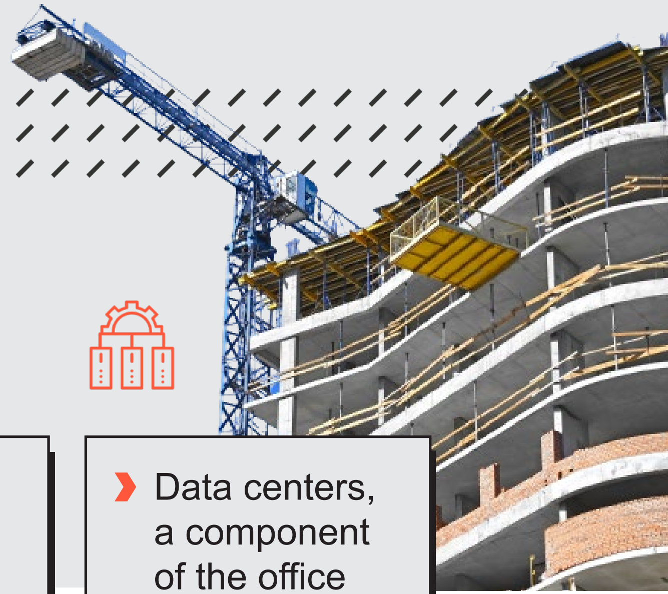
› Multifamily starts will inch up 1% in 2023 to $153 billion as the number of units drops 9% to 723,000.

In the decade following the Great Recession, single family housing starts were considerably subdued resulting in a significant undersupply of housing. The COVID-19 pandemic, however, fostered a significant rebound in starts as many factors combined to favor new development. One of the key factors in the rebound was historically low interest rates. Mortgage rates fell to their lowest since Freddie Mac began collecting data in 1970, creating an explosive period of growth for single family housing.

The strength in single family housing starts, however, has been quelled since the Federal Reserve began aggressively raising interest rates at the beginning of 2022. With little hope for lower mortgage rates in 2023, single family starts are expected to remain subdued. At the same time, relatively supportive demographics and continued shortages in housing supply will prevent the housing market from even further declines in 2023.

Multifamily housing starts will also remain subdued in 2023 as slower economic growth begins to erode gains in employment. Job growth is one of the key drivers of the rental side of multifamily housing starts since it encourages young adults to move out of their families' homes and into apartments of their own. The buyer (condo) side of the multifamily housing market will also remain subdued in 2023 for the same reasons as the single family market. Combined, these factors will keep multifamily starts from gaining footing in 2023.

Commercial Construction



-3%

- Commercial construction will see a pointed falloff in activity during 2023 as starts decline 3% to $153 billion and square footage falls a more substantial 15% to 921 msf.

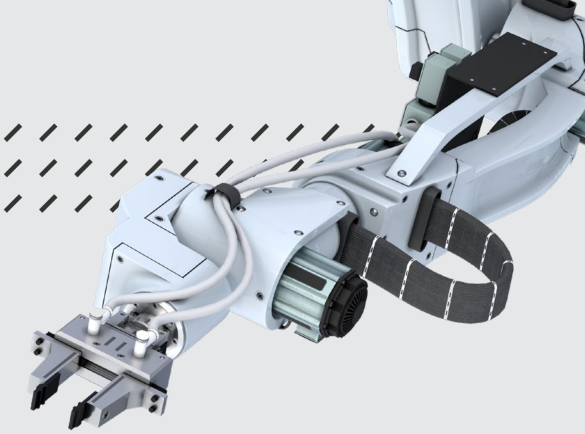
- All components of commercial construction are expected to pull back square footage amounts during 2023 until the economy begins to improve.

- Data centers, a component of the office market in Dodge data, will remain a source of strength.

Commercial construction is closely tied to overall economic conditions and is therefore particularly vulnerable to the deteriorating economic climate in 2023. Adding to the problems of the commercial sector, warehouse construction (which has been the strongest component of commercial growth since before the pandemic) is now overbuilt and poised to decline beginning in 2023. The outlook for retail, hotels, and traditional offices is also precarious given the long-lasting impact of COVID-19 on demand for these facilities.

Demand for brick-and-mortar retail construction, for example, has been weakened by online shopping, demand for traditional office construction has been hampered by strong trends in work from home, and demand for hotel construction has been diminished by the slow return of business travel. One bright light in the outlook, however, lies with data centers. Data centers, which are a component of the office market in Dodge data, will remain a source of strength thanks to their support of new demand for bandwidth stemming from online shopping and work-from-home needs.

Manufacturing



-43%

- Manufacturing construction soared in the aftermath of COVID-19 as more companies attempted to improve supply chains by onshoring production.

- Nevertheless, after a massive run-up in activity during 2022, manufacturing will see steep declines in 2023: starts will plunge 43% to a still-elevated $51.2 billion, and square footage will drop 17% to 122 msf.

The manufacturing industry and construction of new production facilities were hard hit in 2020 as supply chains were upended by the COVID-19 recession. As they looked to find new ways to improve their distribution of goods, many manufacturers began to move production facilities closer to their end markets. In the U.S., this meant a large amount of onshoring for production after decades of moving offshore. Several new federal programs were also passed by Congress to support these efforts — particularly for high value production and industries sensitive to homeland defense.

The CHIPS Act, for example, was passed in 2022 to support an increase in the number of semiconductor plants (or Fabs) within U.S. borders. In addition, the Inflation Reduction Act of 2022 (IRA) was passed to help improve supply chains and bolster new investment in domestic manufacturing. These efforts will not prevent a decline in manufacturing during 2023 since the decline will be at least partly in response to the intrepid gains of 2022. They will, however, help reduce the impact of near-recession conditions and keep levels well above recent historic norms.

Institutional Construction

+1%

- Recovery was slower in coming for institutional building construction and starts are now expected to remain flat in 2023 at $171 billion while square footage ekes out a 1% gain to 308 msf.

- Healthcare will be the bright spot of the sector.

Institutional construction starts are the more insulated piece of nonresidential building since much of institutional construction is funded by public revenues that tend to lag economic trends. While most of nonresidential construction is expected to turn downward in 2023, institutional starts will be able to remain flat and square footage will even be able to remain slightly positive.

Within the sectors of institutional building will be a mix of pluses and minuses. The largest positive will come from the healthcare sector where dollar value will grow 14% and square footage 9% due to the need for surge capacity in the wake of COVID-19. The dollar value of education and government buildings will also remain positive in 2023 as these buildings are renovated to improve HVAC systems and internal air quality (also in the wake of COVID-19). The dollar value of transportation buildings, however, will see a sharp plunge — due less to economic conditions than to strong surges experienced over the past two years as several massive airports underwent renovation.

Nonbuilding Construction

+16%

IIJA

- Nonbuilding/infrastructure construction will increase 16% in 2023 to $281 billion as both sides of this market make gains. Public works will grow 18% to $225 billion, and power/utilities will expand 8% to $56.4 billion.

- Thanks to the $1.2 trillion Infrastructure Act (IIJA), all areas of public works will expand in 2023 and four of the six sectors will grow by double digits.

Expected growth in public works is supported by several recent federal legislative initiatives that have provided ample funding for infrastructure projects over the coming year. Notably, the Infrastructure Investment and Jobs Act (IIJA), signed into law at the end of 2021, provided $1.2 trillion to invest in the nation's roads, bridges, transit systems, airports, waterways, drinking water and wastewater systems, as well as energy infrastructure. As part of that bill, surface transportation funding was reauthorized at a robust $304 billion over five years and $47 billion was added for other transportation-related projects.

The risk, however, remains that Congress will fail to pass appropriations before the current continuing resolution expires. If temporary funding extends too far into early 2023, the expected increase in IIJA funds would be significantly delayed and could lower 2023 construction starts.

Conclusion

While the future is always uncertain, Dodge Data & Analytics can customize forecasting and analytics products to meet your specific needs. Dodge forecasts 22 different types of construction from the U.S. down to the county level to provide customizable geographies that match your sales or operations territories. Our industry-leading team of in-house construction economists and database of more than 100,000 projects in planning will energize your sales and provide a leg up over the competition. Reach out to fuel your growth!

About Dodge Construction Network

Dodge Construction Network leverages an unmatched offering of data, analytics, and industry-spanning relationships to generate the most powerful source of information, knowledge, insights, and connections in the commercial construction industry.

The company powers four longstanding and trusted industry solutions—Dodge Data & Analytics, The Blue Book Network, Sweets, and IMS—to connect the dots across the entire commercial construction ecosystem.

Together, these solutions provide clear and actionable opportunities for both small teams and enterprise firms. Purpose-built to streamline the complicated, Dodge Construction Network ensures that construction professionals have the information they need to build successful businesses and thriving communities. With over a century of industry experience, Dodge Construction Network is the catalyst for modern commercial construction.

To learn more, visit construction.com.