Construction Industry Forecast 2019

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A Year of Continued Optimism

For the 43rd annual Wells Fargo Construction Industry Forecast, we are pleased to report that industry executives from 48 states responded to our in-depth survey seeking their opinions about the construction industry in 2019. The primary goal of the survey is to determine the 2019 U.S. National Optimism Quotient (OQ), which is a key indicator of whether or not local, nonresidential construction is expected to increase or decrease in the year ahead. In addition to determining the OQ, the survey posed questions about equipment sales and purchase expectations, trends in the rental market, and explored major concerns and challenges that industry participants identify as relevant to their businesses.

With the OQ at 122 and in strongly optimistic territory, 2019 marks the eighth consecutive year that participants in the construction industry have felt that industry expansion is more likely than contraction. Looking at the components in depth, 52% of respondents feel an increase is likely, 44% feel that the industry will remain the same, and only 4% of respondents feel that nonresidential construction in their area is likely to decrease in 2019. It's important to note that many feel even if activity remains the same, this is positive for the industry as there has been significant growth for many years. Knowing that only 4% feel a contraction is likely is another positive sign, especially in comparison to years like 2013 or 2016 where 9% and 12% felt a decline was more likely. Growth is likely, but the pace of growth may slow somewhat. Further evidence of this is the two-year outlook; just 51% of respondents feel the industry is more likely to expand, and 27% feel a contraction is more likely in the next two years. This contrasts with the results in 2018 where 76% felt expansion was most likely and only 9% felt a contraction was coming.

In response to expected future construction activity, contractors certainly still plan to acquire new and used equipment with close to 96% of contractor respondents reporting likely plans to purchase new equipment. Plans for used equipment acquisition are similar with nearly 88% indicating that they will likely acquire used equipment in 2019.

Over the past 20 years, equipment rental has been an increasingly important component of contractors' fleet management strategy. For 2019, 92% of contractors told us that they will probably maintain or increase their level of rental activity. This compares to 82% who said the same thing in 2016. For anyone wondering why contractors rent, the response is overwhelmingly in favor of "flexibility" with 46% of contractors who rent equipment citing this as their top reason. This response is more than double the rate of the reasons that are tied for the number two spot — having readily available equipment and building equity before purchase. When responding to the question about top cost concerns in the industry, not a single contractor cited equipment rental costs as their top concern.

Speaking of top concerns, the #1 concern in two survey categories is the ability to hire qualified workers. This theme was also evident in the open-ended comments provided by survey respondents; many of these comments are included verbatim throughout this report. We are also printing comments from survey participants on a variety of topics, including the adoption of technology, and things that could potentially shape the industry in years to come.

If 2019 turns out the way survey respondents indicate, we could be in for another good year. Of course, with the moderating optimism of the mid-term outlook, 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 contact us with any questions you have about the survey. We are glad to give you our perspective and interpretation of the results at your convenience.

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Survey Method

Overview

The survey results presented in this 2019 Construction Industry Forecast represent the 43rd 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 441 construction industry executives in 48 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 10% (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.

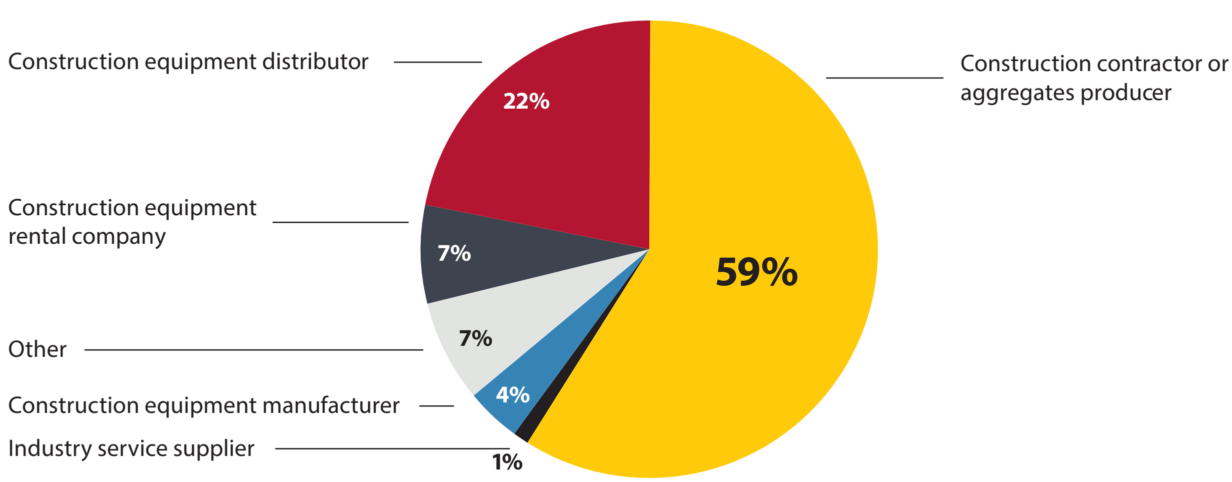
Survey dates

November 6 – 28, 2018

Composition of survey respondents

Most respondents (97%) have been in the construction industry for five years or more. Site preparation/excavation and heavy highway are the most common industries among respondents.

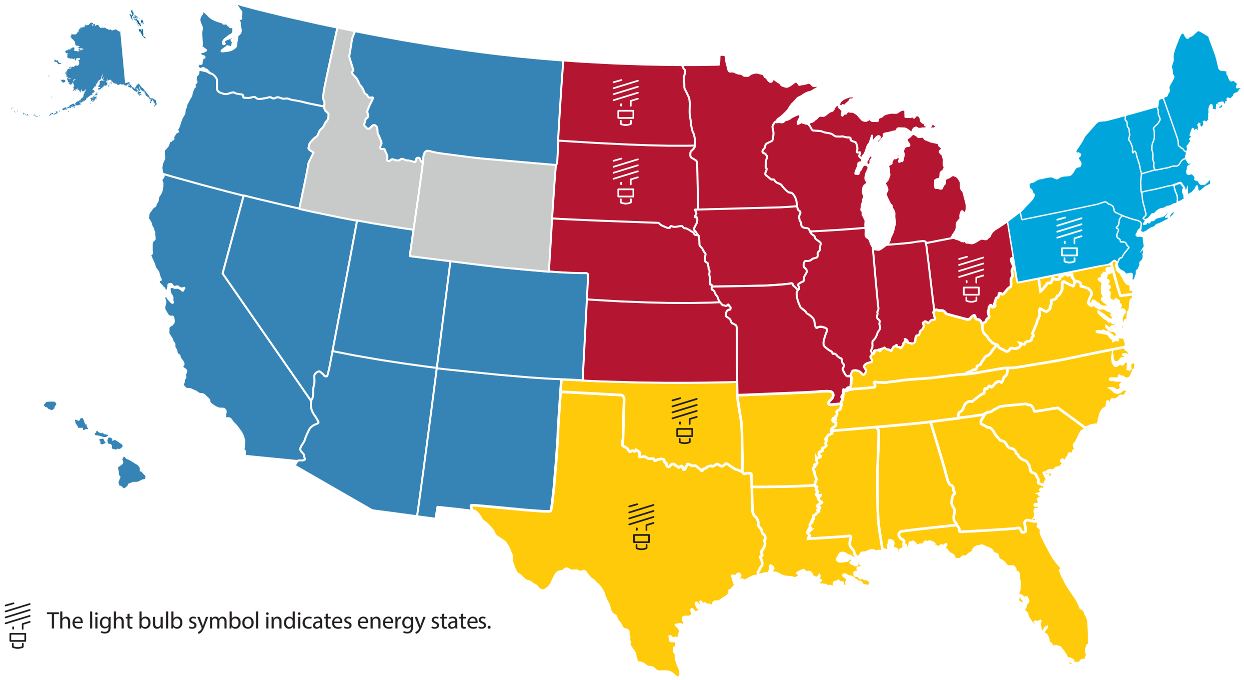
What best describes your company's primary function in the construction industry?



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.

Base: 441 respondents

Graphic distribution of survey respondents



West — 27%
AK, AZ, CA, CO, HI, MT, NM, NV, OR, UT, WA

Midwest — 21%
IA, IL, IN, KS, MI, MN, MO, ND, NE, OH, SD, WI

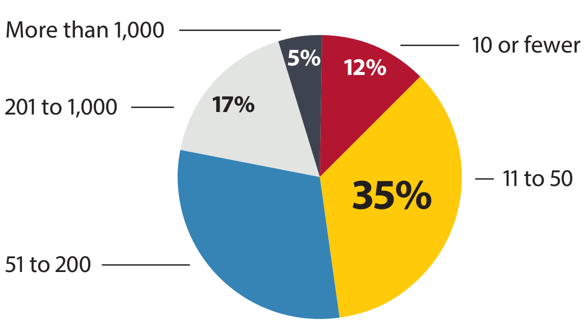
South — 36%
AL, AR, DE, FL, GA, KY, LA, MD, MS, NC, OK, SC, TN, TX, VA, WV

Northeast — 15%
CT, MA, ME, NH, NJ, NY, PA, RI, VT

Responses were received from 48 states. Idaho and Wyoming were not included in the pool of respondents for 2019. Washington D.C. was not included. Note: The following are the proportions of survey responses from energy states: 17% (2019), 23% (2018), 24% (2017), 17% (2016), and 22% (2015). Base: 441 respondents.

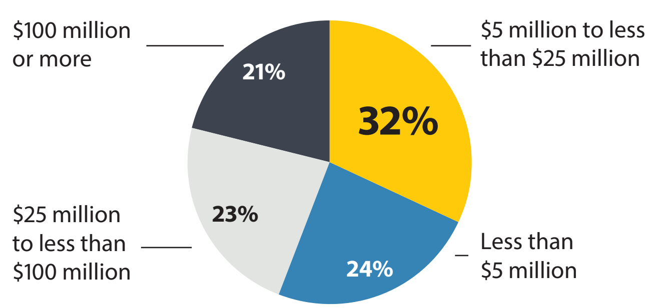
Companies ranging in size and revenue were surveyed; about 6 in 10 companies have more than 50 employees and one half have $25 million or more in revenue.

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



Base: 441 respondents
52% have 51+ employees. 47% have 50 or fewer employees.

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



Base: 441 respondents.

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

Category	2019
Site preparation/excavation	24%
Heavy highway	21%
Concrete and asphalt	13%
Nonresidential building	10%
Utility contracting	10%
Residential building	8%
Oil and gas	3%
Mining	2%
Aggregates production	1%
Bridges and overpasses	1%
Materials transport	1%
Other	5%

Base: 441 respondents.

WHAT WILL CHANGE THE INDUSTRY IN THE FUTURE? WHAT WILL BE THE FACTORS THAT WILL DRIVE CHANGE?

"Technology and automation will drive the future."

— SURVEY RESPONDENT

The 2019 Optimism Quotient is 122

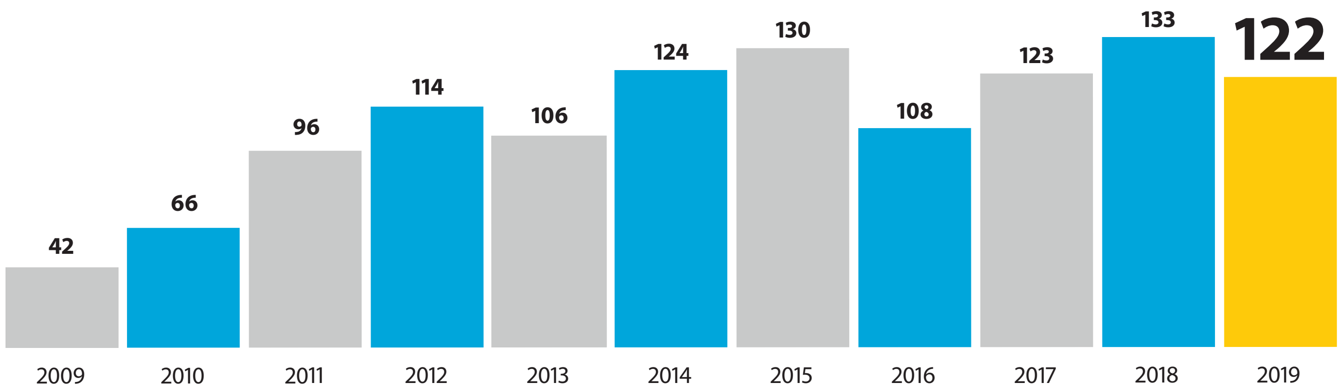
A year of continued optimism

The Optimism Quotient (OQ) — this survey's primary benchmark for measuring contractor and equipment distributor sentiment on local nonresidential construction activity — is 122 for 2019, a tempered decrease from 2018's record high, but still strongly optimistic. Most executives do have a positive outlook for construction activity in 2019 and they also have a positive outlook on net profits in the coming year.

An OQ score of 100 or more represents strong optimism for increased local construction activity relative to the perceived level of activity for the prior calendar year.

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.

U.S. National Optimism Quotient

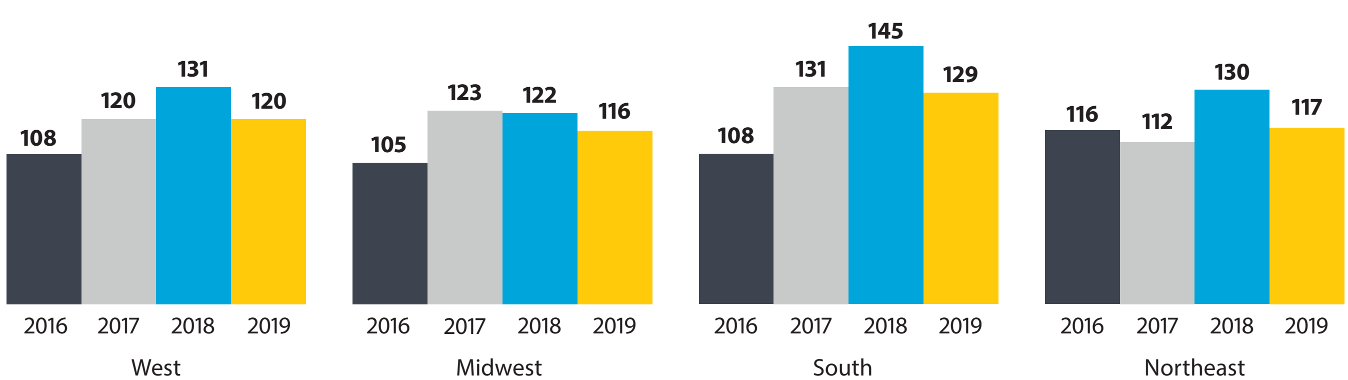


Base: Total respondents: 2019 (N=441), 2018 (N=312); 2017 (N=407); 2016 (N=474); 2015 (N=413); 2014 (N=552); 2013 (N=370); 2012 (N=405).

Optimism for local nonresidential construction holds strong at 122 for 2019, but slightly lower than 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

While the Optimism Quotient as measured is down among regions, every region in the country is in highly optimistic territory.



Base: Total respondents.

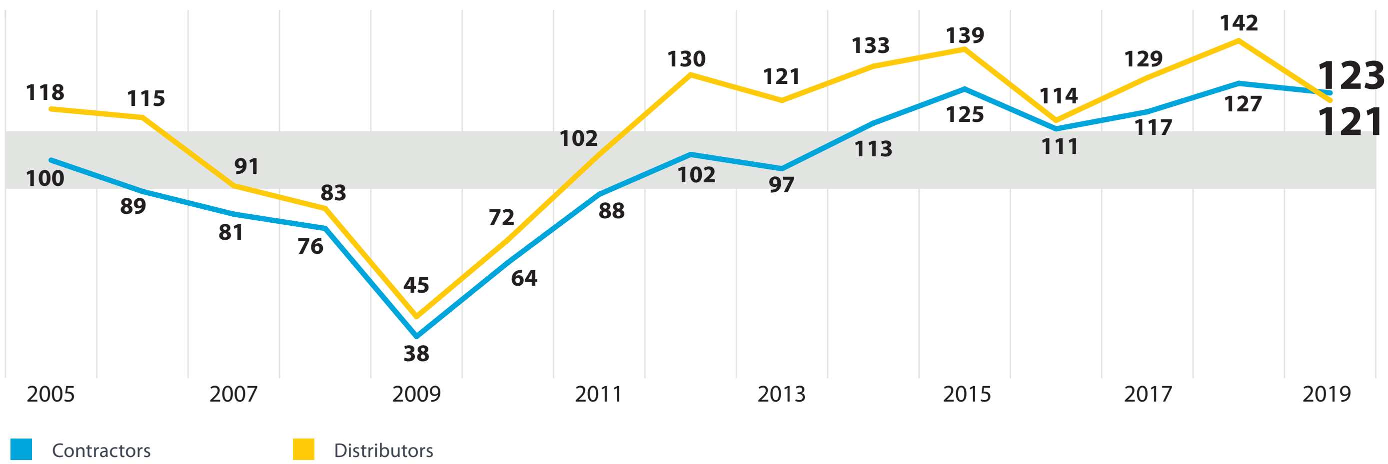
Optimism gap has narrowed

The gap in optimism between distributors and contractors narrows in 2019. Overall, optimism decreased among both distributors and contractors, but it's important to note that optimism still remains very strong. Historically, distributors have expressed higher optimism than contractors, but for 2019, the gap narrows with distributors' optimism decreasing from 142 to 121.

Equipment manufacturers (124) and other groups (116) surveyed have similar OQ scores as distributors and contractors. These groups tend be less optimistic about local nonresidential construction activity on average, which brings down the overall OQ score of 122 shown on the previous page.

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.

Distributors and Contractors U.S. National Optimism Quotient



Base: Total 2019 contractors (262), plus distributors and rental companies (127).
Equipment manufacturers (16^), and other (36^). ^Small base size.

WHAT WILL CHANGE THE INDUSTRY IN THE FUTURE?
WHAT WILL BE THE FACTORS THAT WILL DRIVE CHANGE?

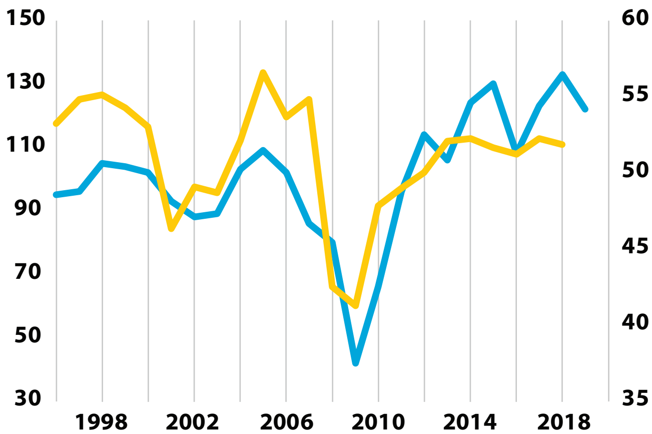
"Innovation in construction equipment, such as drone or the elimination of operating personnel via technology, could be a major change. Lack of skilled labor and improving technology will drive the change."

— SURVEY RESPONDENT

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

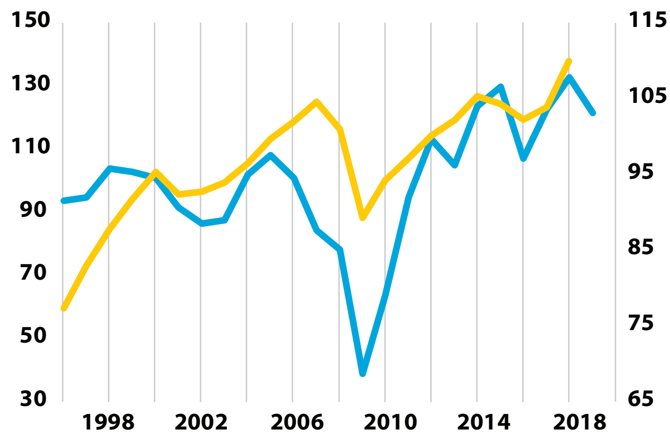


Optimism Quotient: 2019 @ 122 (Left Axis)

Total AIA Billings: 2018 @ 52.1 (Right Axis)

Source: Wells Fargo Securities, LLC.

Optimism Quotient vs. Industrial Production Index

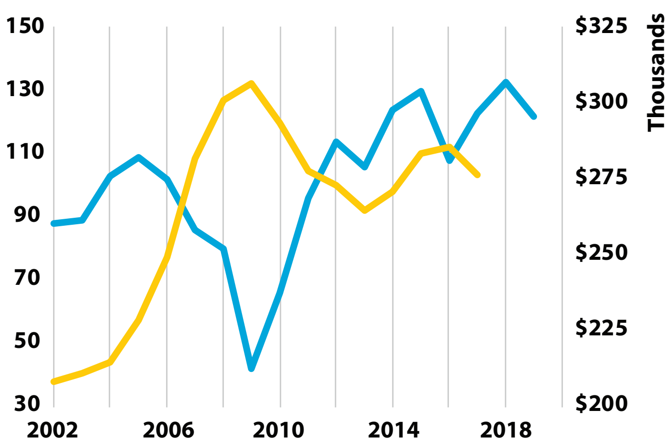


Optimism Quotient: 2019 @ 122 (Left Axis)

Industrial Production: 2018 @ 107.8 (Right Axis)

Source: Wells Fargo Securities, LLC.

Optimism Quotient vs. Public Nonresidential Construction Index, Billions of Dollars

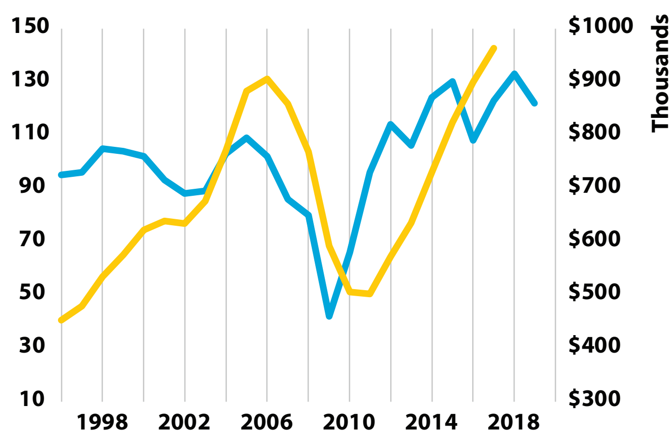


Optimism Quotient: 2019 @ 122 (Left Axis)

Public Nonresidential Value Put-in-Place: 2017 @ $276.5B (Right Axis)

Source: Wells Fargo Securities, LLC.
Annualized data not yet available for all of 2018.

Optimism Quotient vs. Private Construction Index, Billions of Dollars



Optimism Quotient: 2019 @ 122 (Left Axis)

Private Value Put-In-Place: 2017 @ $962.8 B (Right Axis)

Source: Wells Fargo Securities, LLC.
Annualized data not yet available for all of 2018.

Survey Results

The top four learnings for 2019

1 Industry Optimism

The Optimism Quotient (OQ) for 2019 is very strong at 122. Although it represents a slight dip from last year, this is the 8th year in a row that survey participants have felt that industry expansion is more likely than contraction in the coming year. An OQ of 122 is considered strongly optimistic.

2 Equipment Acquisition

96% of contractor respondents plan to purchase new or used equipment in the coming year. Of those, 76% plan to maintain or increase their purchases of new equipment compared to the prior year.

Purchase plans for used equipment are similar — 75% say that they will increase or maintain their level of purchasing used equipment, and nearly 13% said they would not purchase used equipment at all.

3 Equipment Rentals

92% of contractor respondents intend to maintain or increase their level of rental activity. 46% of those who rent equipment say that the primary reason is flexibility — far above other reasons for renting, including the cost of rentals. Contractors say a strong backlog of jobs are needed to spur an equipment purchase in the future instead of renting.

4 Top concerns

The ability to hire qualified workers is the #1 concern among survey respondents in two categories.

47% of contractor respondents cited the ability to hire qualified workers as their #1 cost concern and 36% of all respondents cited it as the #1 risk to their business.

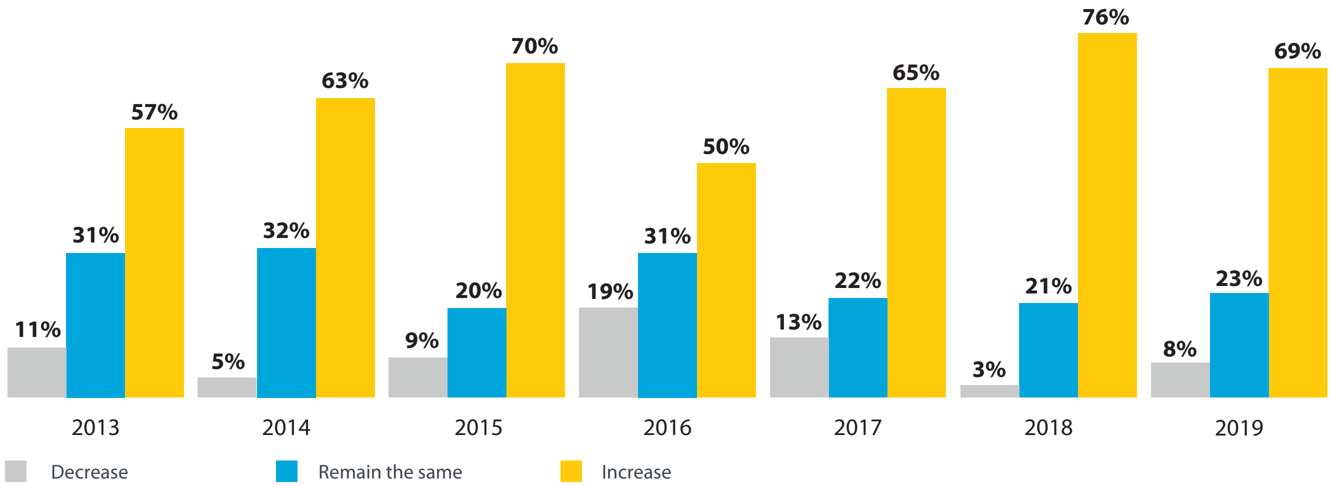
They ranked it above the impact of healthcare costs, employee wages and benefits, tariffs, interest rates, and the cost of equipment.

How do industry executives feel about 2019?

Distributors

Distributors remain generally optimistic regarding future sales of **new** construction equipment. Just over two-thirds of distributor respondents expect **new** equipment sales to increase; this is a lower expectation than last year, but still higher than two years ago in 2017. A larger number of distributors expect to see a decrease in **new** equipment sales in 2019 than in 2018. Those who expect sales to remain steady is nearly the same as last year.

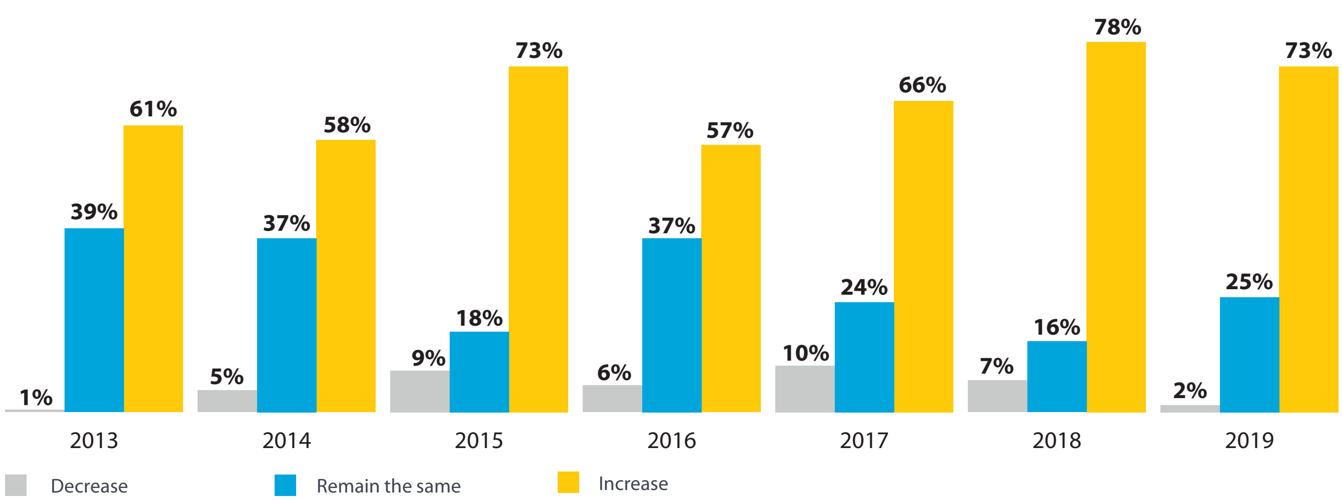
Do you think that your sales of **new construction equipment** this year compared to last year will:



Base: Total distributors and rental companies: 124 in 2019, 103 in 2018, 130 in 2017, 162 in 2016, 132 in 2015.
Historical bases sizes not available for 2013 – 2014.

Distributors are still forecasting strong sales for **used** construction equipment in 2019. Those who reported that they think sales of **used** construction equipment will increase in 2019 declined slightly from 78% to 73%. Although this opinion represents a decline from last year, their forecast is still at the second-highest level in seven years. Nearly three-quarters of distributors anticipate an increase in sales of **used** construction equipment for 2019.

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

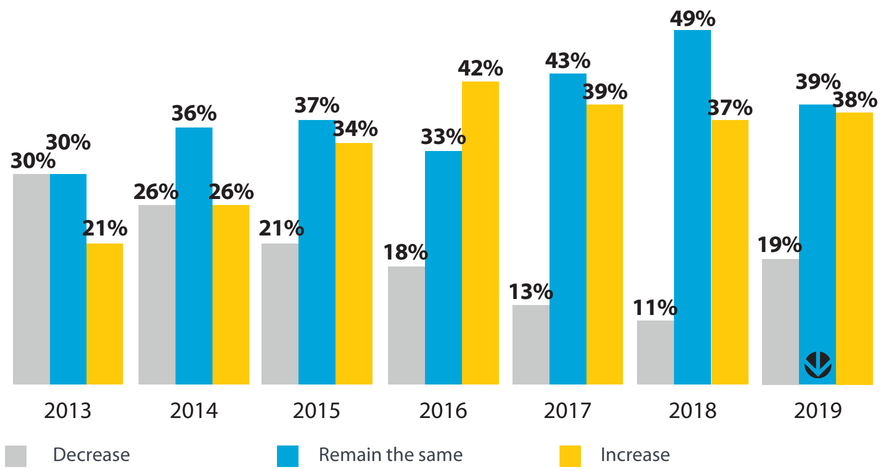


Base: Total distributors and rental companies: 124 in 2019, 103 in 2018, 134 in 2017, 167 in 2016, 132 in 2015.
Historical bases sizes not available for 2013 – 2014.

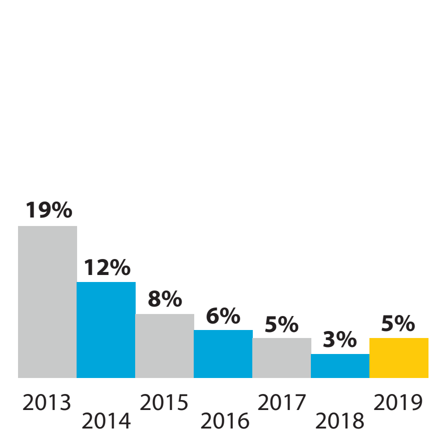
Contractors

Contractors are less optimistic about purchases of **new** equipment in 2019. Just over one-third of contractor respondents believe **new** equipment purchases will increase this year and about the same number of contractors expect new equipment purchases to remain flat. 19% of contractors, expect to see a decrease in **new** equipment purchases in 2019.

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



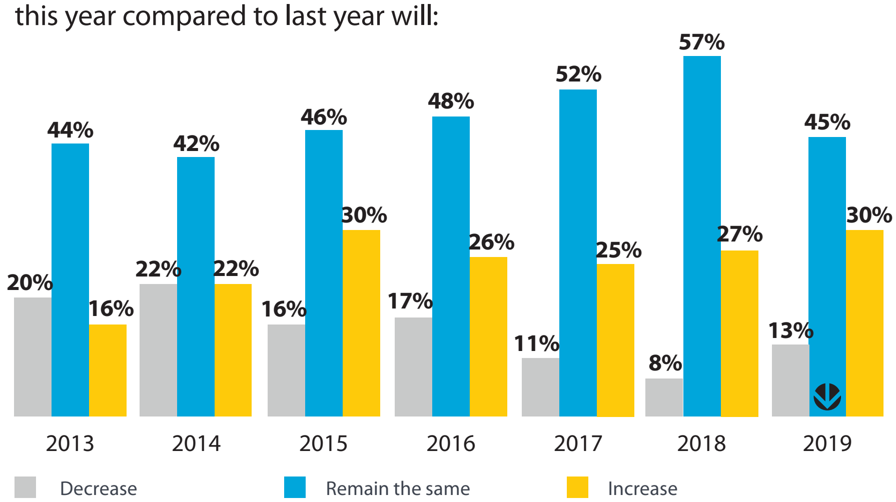
My company will not be acquiring **new equipment**



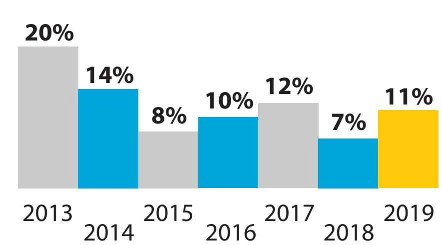
The up/down arrows denote a significant difference from 2018 at the 95% confidence level. Base: Total contractors – 262 in 2019, 150 in 2018, 194 in 2017, 248 in 2016, 238 in 2015.
Historical bases sizes not available for 2013 – 2014.

Contractors' estimates of **used** equipment purchases are forecasted mostly to remain the same or increase; however, their estimates are more conservative than last year. Nearly one-third of contractor respondents expect purchases of **used** equipment to increase, but 45% who expect purchases to remain the same as last year represents a sharp decrease from 57% in 2018.

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



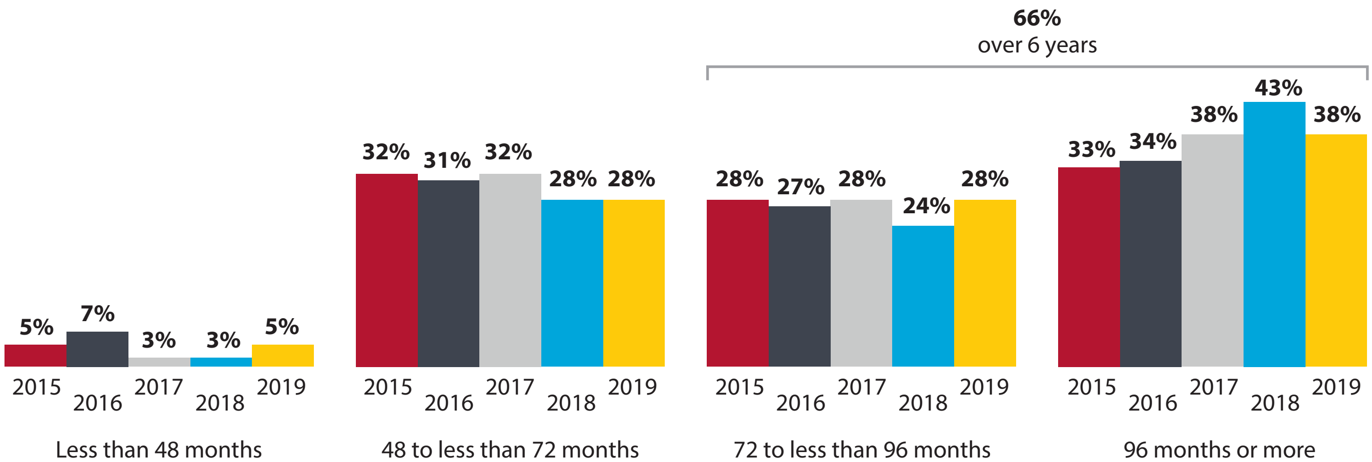
My company will not be acquiring **used equipment**



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, 238 in 2015.
Historical bases sizes not available for 2013 – 2014.

How do industry executives feel about 2019?

Contractors — On average, how long do you own the construction equipment that you acquire?



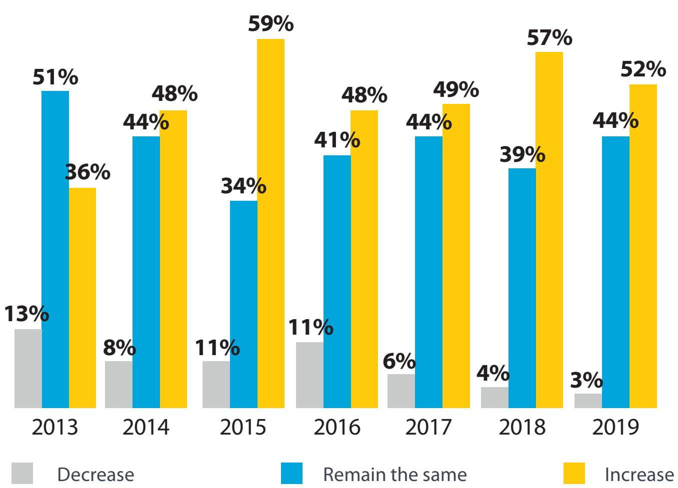
Base: 256 in 2019, 148 in 2018, 193 in 2017, 245 in 2016, 232 in 2015.

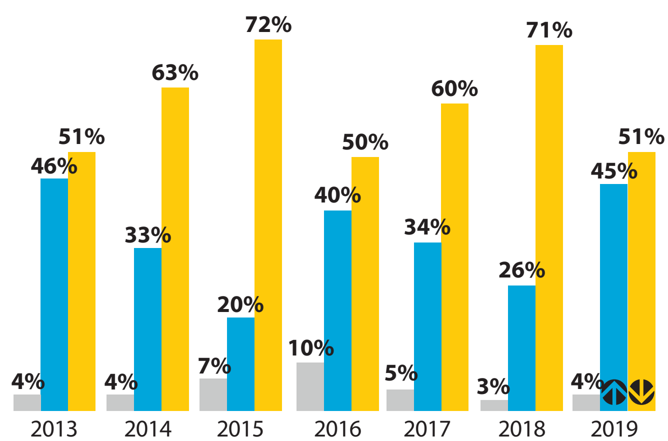
Contractors who own their equipment typically keep it for six years or more, and this trend has been consistent over the last five years of reporting. There was a slight drop in those who reported owning equipment for eight years (96 months) or more (43% in 2018 to 38% in 2019).

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?





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, and 238 in 2015.
Total distributors and rental companies - 127 in 2019, 105 in 2018, 134 in 2017, 174 in 2016, 138 in 2015.
Historical bases sizes not available for 2013 – 2014.

The decline in those who believe nonresidential construction activity will increase is more prominent among distributors. 51% of distributors expect an increase in 2019, versus 71% who expected an increase in 2018. Contractors' expectations for an increase in activity for 2019 also declined from 57% to 52% with this survey, but did not decline as drastically as the distributors' expectations.

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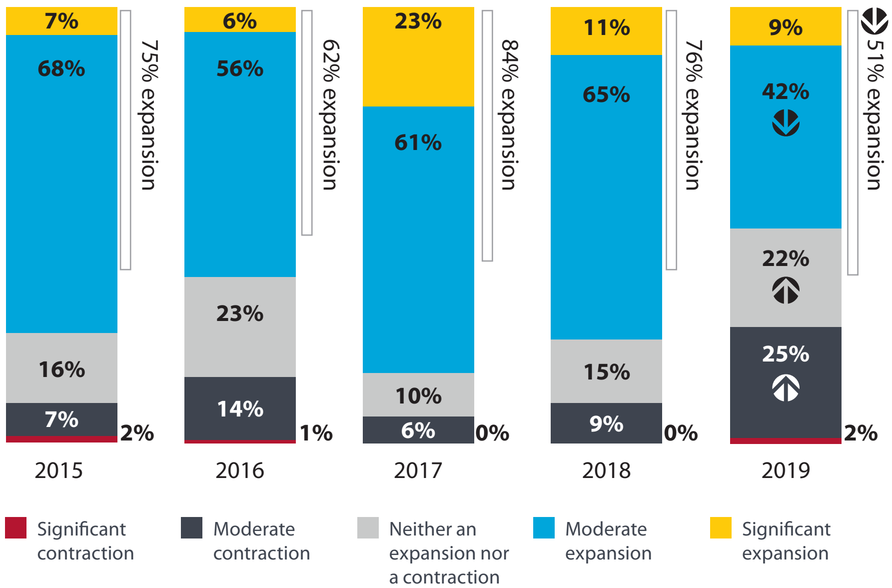
Industry Growth

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



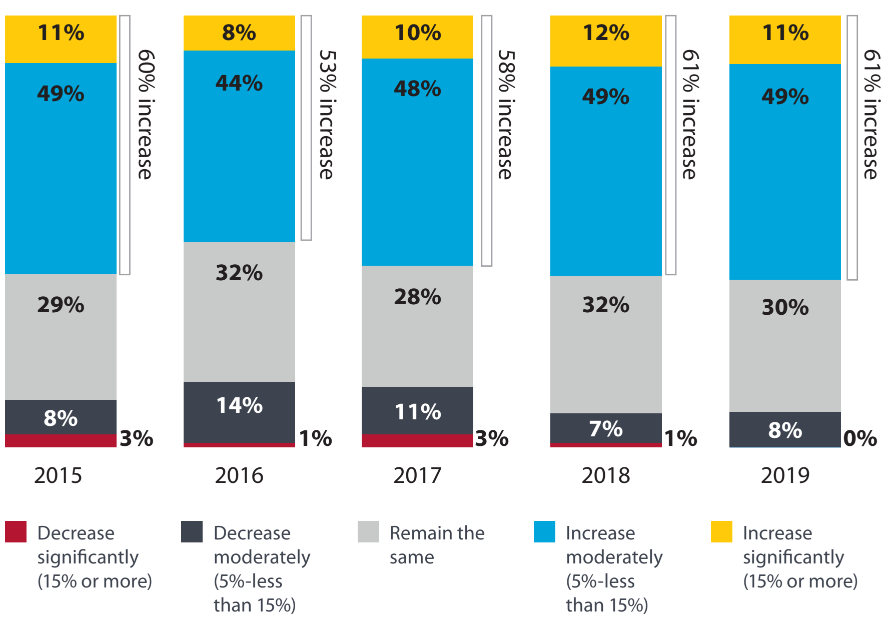
Up/down arrows denote a significant difference from 2018 at the 95% confidence level.
Base: Total respondents – 441 in 2019, 312 in 2018, 407 in 2017, 474 in 2016.
Historical bases sizes not available for 2015.

Perceptions of industry growth over the next two years continue to shift downward for 2019. There is a notable decline (from 76% in 2018 to 51% in 2019) in those who believe that the construction industry will expand in the next two years and a large increase (25% in 2019 compared to 9% in 2018) in those who believe it will contract.

But what about net profits?

Net Profits

Compared to net profits for 2018, do you think your **net profits** in 2019 will:



Base: Total respondents – 441 in 2019, 312 in 2018, 407 in 2017, 474 in 2016, and 413 in 2015.

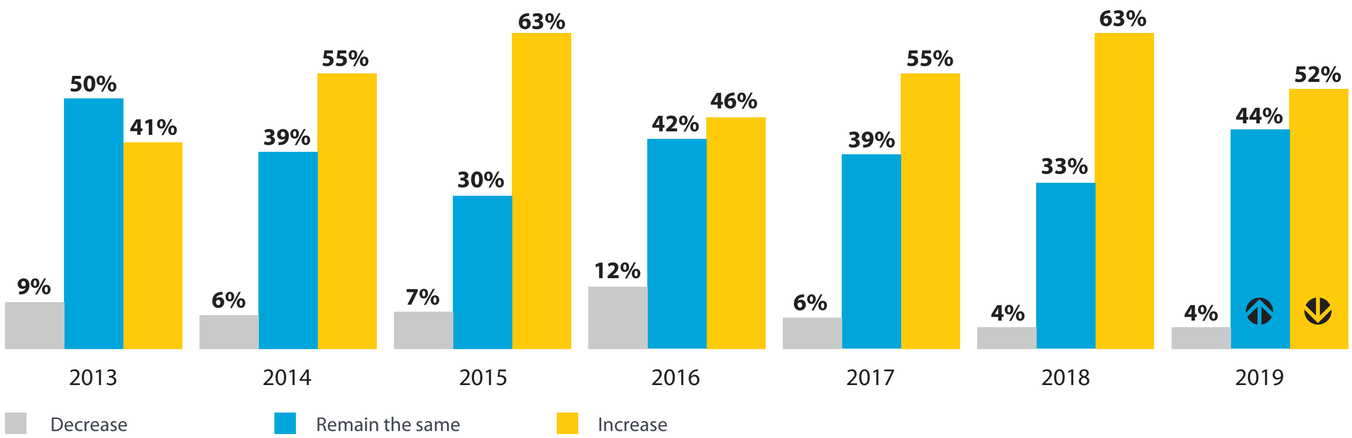
Most executives remain positive about profitability in 2019. 90% feel profitability is going to be the same, or better than last year.

Nearly half (49%) believe net profits will increase moderately and 11% believe net profits will increase significantly.

Nonresidential vs. Residential activity

A shift toward an unchanging forecast for local **nonresidential** activity is evident for 2019. In comparison to 2018, fewer executives (52% in 2019 versus 63% in 2018) project an increase in nonresidential activity. The shift in perception of nonresidential activity in 2019 is evident among distributors, non-energy states, the South region, influencers and larger companies with more than $25M in revenue and companies with more than 50 employees. Those who expect nonresidential activity to decrease in 2019 has remained the same at only 4%. Far more (44%) expect activity to remain the same than in 2018 (33%). Among executives who expect nonresidential activity to remain constant, most (74%) believe improvement will happen in late 2019 or beyond.

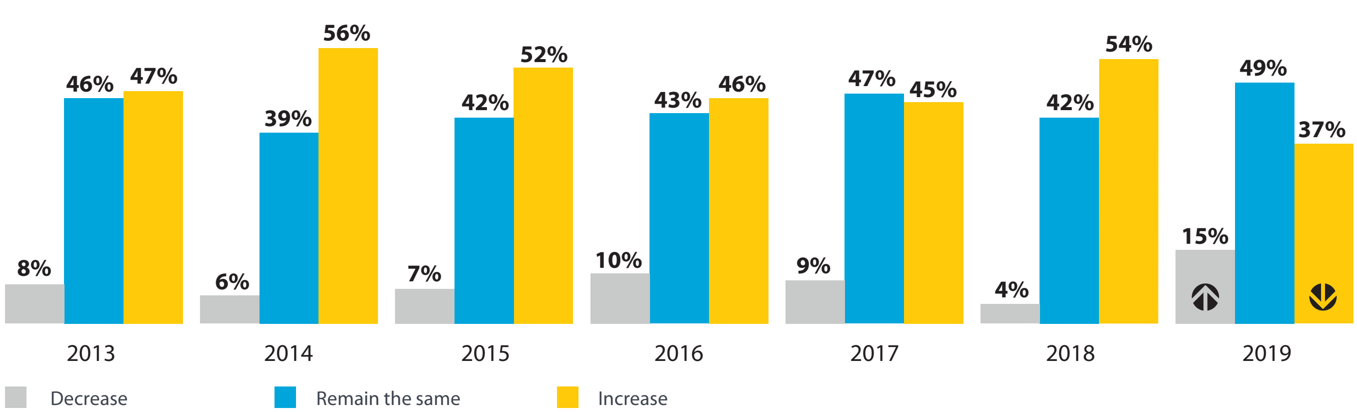
What is your projection for local **nonresidential construction** activity in 2019 compared to 2018?



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, 413 in 2015, 552 in 2014, and 370 in 2013.

For local **residential** construction in 2019, 86% think residential activity is going to be the same or higher than last year. Compared to 2018, more executives expect a decrease and fewer expect an increase in activity. In 2018, 54% of respondents expected an increase in residential construction activity, while in 2019, just 37% expect to see an increase, which is a significant drop. There was also a sharp increase among those who expect residential activity to decrease in the next year, jumping up from 4% in 2018 to 15% in 2019. Consistent with 2018, 78% of executives expect residential construction activity to begin improving in Q4 2019 or later.

What is your projection for local **residential** construction activity in 2019 compared to 2018?



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, 413 in 2015, 552 in 2014, and 370 in 2013.

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THINKING ABOUT THE STATE OF YOUR BUSINESS, WHAT CONCERNS DO YOU HAVE? WHAT DO YOU BELIEVE WILL BE HAPPENING IN THE INDUSTRY IN 2019?

"Equipment availability is the main concern. Every manufacturer is having a hard time getting equipment in a timely manner."

— SURVEY RESPONDENT

Construction Industry Overview

Following a strong 2018, the U.S. economy appears to have gotten off to a rocky start in 2019. The fallout from the trade feud with China has led to increased volatility in the financial markets and caused businesses to turn more cautious. Manufacturing activity has pulled back considerably and looks like it will either stall or contract during the first part of the year. Forecast for economic growth have been scaled back as businesses have turned more cautious.

While our forecast for 2019 called for economic activity to slow, the sluggish start to 2019 was a bit more abrupt than we were expecting. Our forecast for real GDP in 2019 now calls for the economy to grow just 2.6%, with business fixed investment, housing, and nonresidential structures accounting for much of the slowdown. A good bit of the pullback in investment and nonresidential structures is tied to slower growth in the energy patch, where lower oil prices have led to cutbacks in exploration activity. The price of West Texas Intermediate crude fell below $50 a barrel late last year, which is about $10 below the consensus forecast by major oil companies. Investment in midstream projects should continue, however, with several major pipeline additions slated to be completed this year and in early 2020. The additional pipeline capacity will open the door to other projects, including export terminals and refinery expansions.

The outlook for commercial construction has also been scaled back somewhat but there are still plenty of major projects in the pipeline. The past decade has been unusual in that there has been much less new supply brought to the market than in prior cycles, particularly in the office and retail markets. The slower growth in those two markets reflects sluggish demand relative to prior cycles due to structural shifts, most notably the growing popularity of co-working space and the continued growth of online retailing. What new supply has come to market has largely been in three distinct areas: global gateway cities, technology-centric metro areas and energy-driven markets. Moreover, gains in construction in these three markets did not occur simultaneously. The relative lack of new construction has left markets in fairly good balance, with only a handful of tech markets showing any potential signs of overbuilding.

While retail construction has been hampered by the loss of market share by traditional brick-and-mortar stores to online retailers, the industrial market has benefitted immensely from this shift. Demand for industrial space has remained strong throughout this cycle, particularly near major port cities and inland distribution hubs. The growth of online retailing has also fueled demand for fulfillment centers closer to end markets. Brick and mortar retailing has also staged a bit of a comeback with town centers replacing malls and power centers as the preferred destination for high-end retailers.

> *A good bit of the pullback in investment and nonresidential structures is tied to slower growth in the energy patch, where lower oil prices have led to cutbacks in exploration activity.*

Hotel development has enjoyed a strong run, despite continued consolidation within the industry. Occupancy averaged over 66% for the 12 months ending in September — a modern era high. Demand is being driven by both increased business and leisure travel. Occupancy has likely peaked, however, given the rush of new supply being developed and delivered in the next few years. Strong demand over the past few years has induced spending on renovations to older properties in need of greater technological and lifestyle upgrades. The growth in hotel construction does not show much signing of letting up but is looking a little long in the tooth. After rising 12.8% this past year, we look for hotel construction to rise 6.5% in 2019 and 3.0% in 2020.

Single-family residential construction has also been slow to recover in this cycle. The primary culprit has been a sluggish recovery in jobs and income combined with a more rapid recovery in home prices. Home prices have recovered their recession losses on a national basis and

Go to TOC ▸

have risen well above their previous highs in many of the nation's fastest growing job markets, including San Francisco, Seattle, Denver, and Dallas. The rebound in home prices has been much stronger than the rebound in household income, which has caused traditional measures of affordability to tumble. The net result has been that many potential homebuyers have remained in the rental market longer than they planned to. While that has been bad news for homebuilders, the large number of renters renewing their leases has helped stem one of the top concerns from a year ago — which was the onslaught of new apartments. Vacancy rates did tick up early last year but absorption picked up sharply in the second half of 2018, leaving vacancy rates slightly below their year ago levels at yearend.

Heavy construction and civil engineering should also see modest growth in 2019. We expect overall outlays to rise 4.5%, as spending for transportation and infrastructure projects remains strong.

Our housing forecast has single-family starts rising 2.8% in 2019 to 920,000 homes, while multi-family starts maintain their recent strong pace of 375,000 unit pace. Residential development is catching a little bit of a break, as materials prices have eased in recent months. Labor remains in short supply, however, and land development remains cumbersome and expensive, making it difficult to bring much affordable product to market. Overall residential construction spending is expected to fall 0.8% in 2019, however, as home prices moderate and existing home sales remain constrained by supply and affordability concerns.

While financial market jitters, the government shutdown and China trade talks raised concerns about 2019, we expect economic growth to remain slightly above its long-run trend this year, which should support solid growth in demand for commercial real estate. Real GDP is expected to rise 2.6% this year and for nonfarm employment to increase 1.4%. Such growth should support strong growth in demand for office, industrial, and retail space, while also handily accommodating our forecast for residential construction. We are looking for overall structures investment to rise 3.1% in 2019, as continued gains in commercial construction offset some slowing in the energy sector. Outlays for nonresidential buildings are expected to rise somewhat faster, climbing 4.8%.

Commercial construction has strong momentum. After rising 9.8% in 2018, we look for the value of office construction to rise 6.8% in 2019. Vacancy rates have hovered around 10% as developers have been relatively restrained in meeting the steady pace of growth in office demand. With the market fairly balanced, rent growth has moderated since 2015 to a pace below 3%. Rent growth has been weakening in the Northeast, which is rife with industries currently focused on gaining efficiencies through smaller floorplans and agile workspaces, such as finance and other professional service firms.

New York has seen outright rent declines, which should continue as major projects like 3 World Trade Center and Hudson Yards significantly add to supply. The selection of Crystal City for Amazon HQ2 will likely provide a boost to Washington D.C., which had slowed recently. It is little surprise Amazon expanded to the East, as the West is facing some of the highest office rents and fastest rent gains. The same factors motivating Amazon to look east have also encouraged other tech firms to relocate operations outside of high-cost markets along the West Coast. Austin, Atlanta, Nashville, Raleigh, and Charlotte are among the top destinations for businesses seeking lower operating costs but still need access to a deep pool of skilled workers.

Markets enjoying a steady influx of new businesses and new residents are also likely to see the strongest growth in retail development. While the retail sector is facing some significant challenges, talk of a retail apocalypse is a bit over-the-top. To be certain, more than a third of 390 tracked markets experienced negative absorption in Q3.

Q4 got off to an ominous start as Sears — for decades the nation's largest retailer — filed for Chapter 11 bankruptcy. Developers are already looking to repurpose much of this newly vacated space and many properties are being remade into town centers, office space, and experiential businesses, including breweries and other family or young adult entertainment venues.

Heavy construction and civil engineering should also see modest growth in 2019. We expect overall outlays to rise 4.5%, as spending for transportation and infrastructure projects remains strong. Spending for highways, streets, and road improvements is expected to rise 5% this year. Spending for mass transit systems rises somewhat faster than that but is growing off a significantly smaller base. Spending for both light rail and subway projects remains in high gear, although the bulk of the impact is limited to a relative handful of markets. Spending for airport projects looks set to grow about 6% this year, with all facets of airports seeing growth, including parking, terminals, runways, and rental car facilities. Investment in seaports and harbors should rise about 4%, reflecting growing demand for container facilities and rail facilities to move freight efficiently to the growing number of inland ports operating around the country.

Mark tracks U.S. and regional economic trends for Wells Fargo. He writes for the company's Monthly Economic Outlook report and the Weekly Economic & Financial Commentary, as well as provides regular updates on the housing markets, commercial real estate, regional economies, consumer spending, and small business issues.

Mark's commentary has been featured in the New York Times, The Wall Street Journal, and Bloomberg, among other publications. Originally from Atlanta, Mark earned a B.B.A. in economics from the University of Georgia and an M.B.A. from the University of North Florida. He spent nine years as an economist for Barnett Banks in Jacksonville, Florida, before joining a Wells Fargo predecessor in 1993. Mark is based in Charlotte, North Carolina.

Mark Vitner
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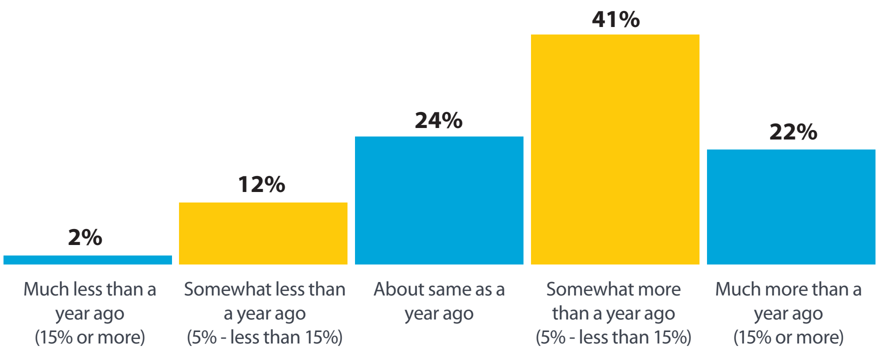
Wells Fargo Securities, LLC

Rental Review

Contractors and distributors agree that rentals will be on par this year, or better than last year. In response, distributors signal they intend to maintain or increase their fleet sizes.

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



Base: Total distributors and rental companies: 127 in 2019.

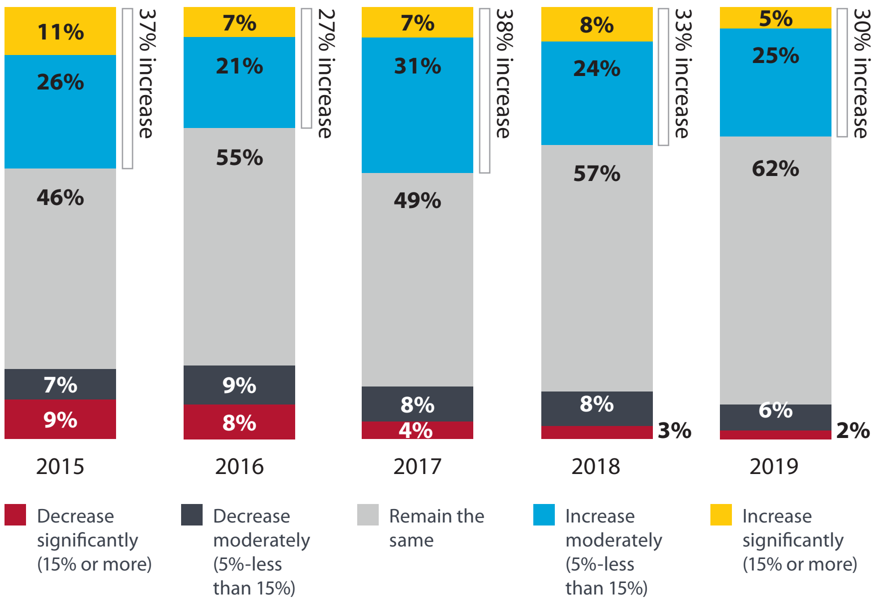
Growth in the rental market is still rising for distributors and rental companies. Most distributors are renting out more equipment than they did a year ago. Distributors report an increase (22% in 2019 versus 18% in 2018) and say they plan to rent out much more than a year ago. Two new questions were added to the survey this year regarding time and financial utilization of rental fleets. Most (66%) say that their time utilization of their rental fleet falls between 50 and 80%. However, financial utilization of distributor rental fleets is typically less than 70%.

WHAT WILL CHANGE THE INDUSTRY IN THE FUTURE?
WHAT WILL BE THE FACTORS THAT WILL DRIVE CHANGE?

"We are rapidly heading into full capacity. In the short term demand will outstrip supply forcing prices higher. Higher prices reduce the number of projects that are financially feasible reducing demand. I expect to see our typical industry boom/bust cycle. I expect the highs and lows to be more muted than in the recent past."

— SURVEY RESPONDENT

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



Base: Contractors that rented heavy construction equipment – 204 in 2019, 119 in 2018, 155 in 2017, 208 in 2016, and 189 in 2015.

Unchanged from 2018, contractors who rent heavy equipment primarily think their renting behaviors will not change. Contractors feel their fleet sizes are in balance. More than half (62%) plan to hold steady with their fleet sizes with 30% (combined) planning to increase or increase significantly in 2019 as long as rental prices remain fair.

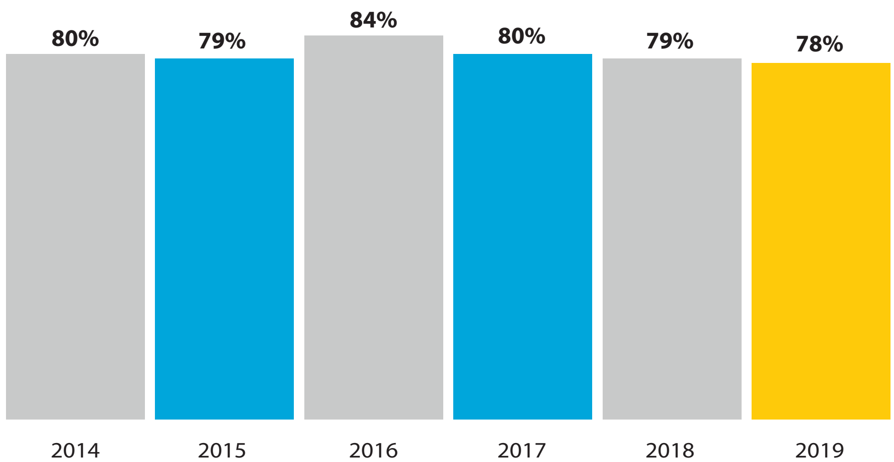
Contractors — Why do you rent construction equipment? Please rank the top three.

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

Up/down arrows denote a significant difference from 2018 at the 95% confidence level.
Base: Contractor respondents: 262 in 2019, and 150 in 2018.

Flexibility continues to be a key factor in the decision to rent equipment. There is a large increase (20% in 2019 compared to 9% in 2018) in those who indicate building equity before purchasing is an important reason for renting equipment and, according to another survey question, the most common duration for the rental period is monthly.

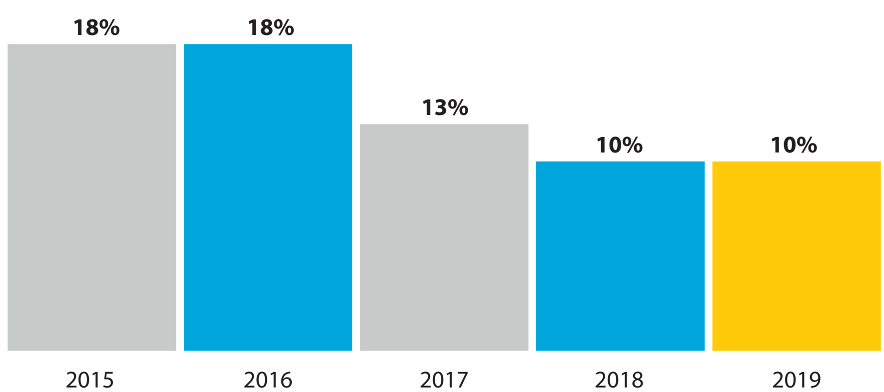
Contractors — Did your company rent any heavy construction equipment in 2018? (% – Yes)



Rental of heavy construction equipment remains strong and on par with previous years. Over three-quarters of contractors rented heavy construction equipment in 2018. Of those who did not rent in 2018, only 10% predict they will rent in 2019.

Base: Total contractors – 262 in 2019, 150 in 2018, 194 in 2017, 248 in 2016, 238 in 2015, and 261 in 2014.

Contractors who did not rent heavy construction equipment in 2018 — Do you think that you will rent heavy construction equipment in 2019? (% – Yes)



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

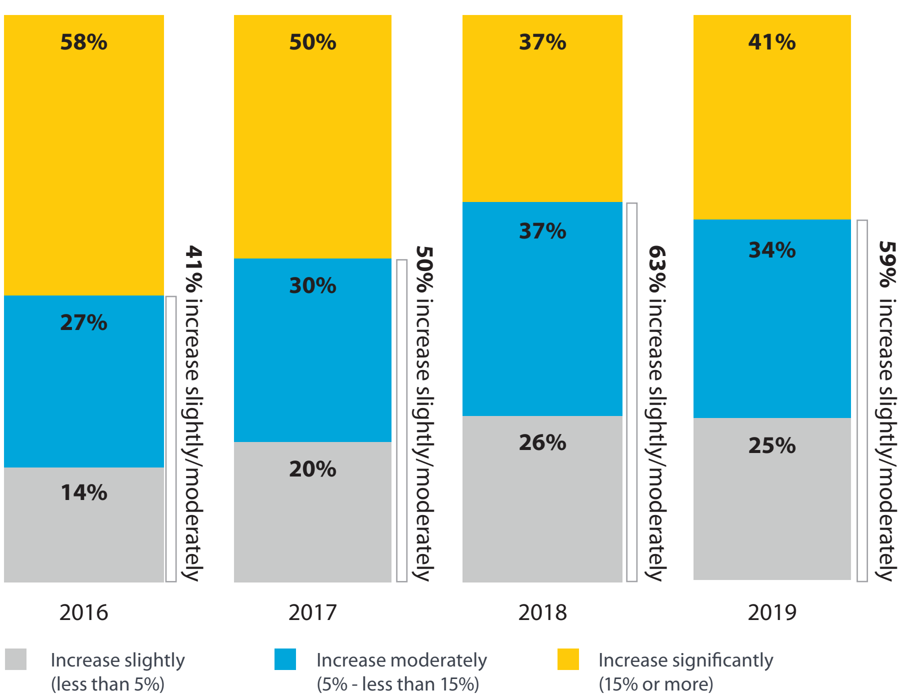
Contractors — What would need to happen for you to want to **buy** construction equipment?

Most important factors	2019
Stronger backlog of jobs	22%
Long-term confidence in the local economy	22%
Ability to hire workers to operate the equipment	12%
Special low rate interest programs	10%
Lower equipment costs	9%
Long-term confidence in the national economy	9%
Passing of a long-term highway funding bill	7%
My company would not consider buying construction equipment in 2019	3%
Other	6%

Base: Total contractors – 262 in 2019

A stronger backlog of jobs remains most important to contractors when considering buying over renting; very similar to last year. Long-term confidence in the local economy is another top driving factor in contractors' willingness to buy equipment. Other indicators that may spur purchases instead of rentals would be the ability to hire qualified workers and special low interest rate programs.

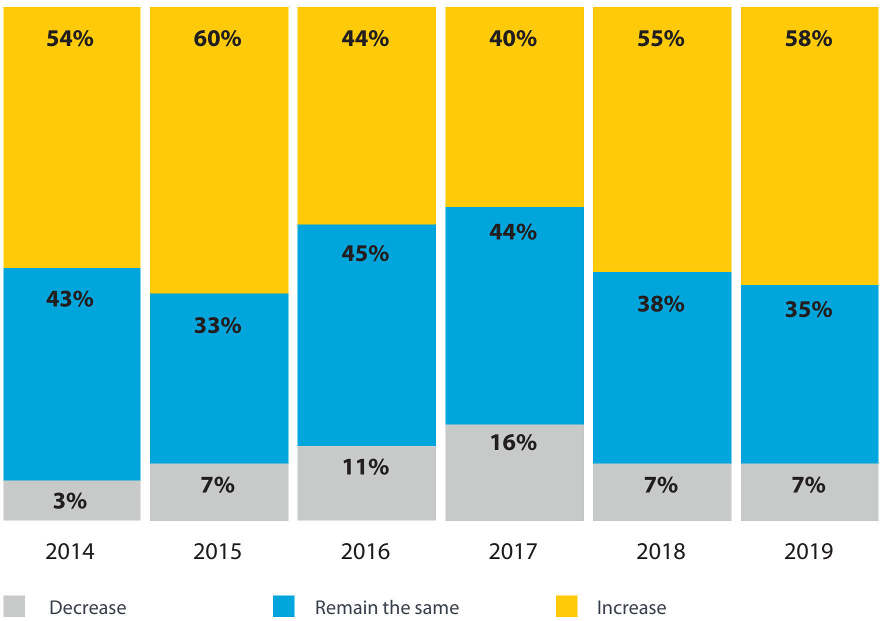
Contractors — How much would construction equipment rental costs need to increase for you to **consider buying** instead of renting equipment?



For many contractors (59%), 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 – 244 in 2019, 150 in 2018, 194 in 2017, 248 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 – 127 in 2019, 105 in 2018, 134 in 2017, 174 in 2016, 138 in 2015, and 175 in 2014

Consistent with 2018, distributors generally think that the size of their rental fleet will increase or remain the same. Also, on par with last year, only a small portion of distributors (7%) expect to decrease rental fleet sizes. This bodes well for contractors who plan to supplement their fleet size with rentals.

WHAT WILL CHANGE THE INDUSTRY IN THE FUTURE?
WHAT WILL BE THE FACTORS THAT WILL DRIVE CHANGE?

"Increases in the use of robotics, telematics, and other labor-saving, efficiency-focused initiatives. Workforce challenges will be an ongoing and worsening situation, but those companies who can address the problem creatively will prosper. We intend to be one of those companies!"

— SURVEY RESPONDENT

Risk, Regulations, and Opportunities

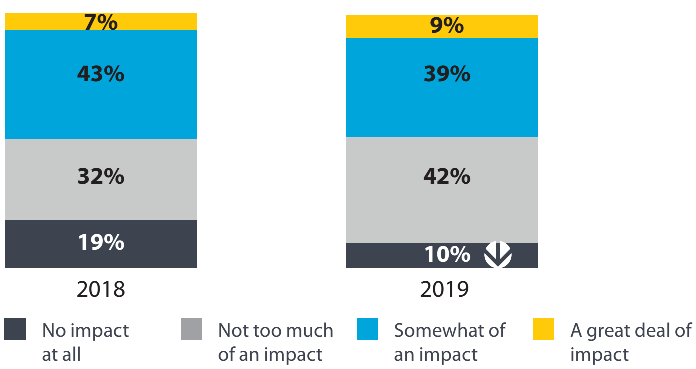
Accounting changes: Are you aware?

As in 2018, 46% of executives are aware of the pending changes to accounting rules for leasing. Their perceived impact of the pending changes to the accounting rules varies though; with nearly half (48%) believing it will have a great deal or somewhat of an impact. Concern about the impact of the pending changes shifts though, with most (71%) being slightly, or not at all concerned.

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

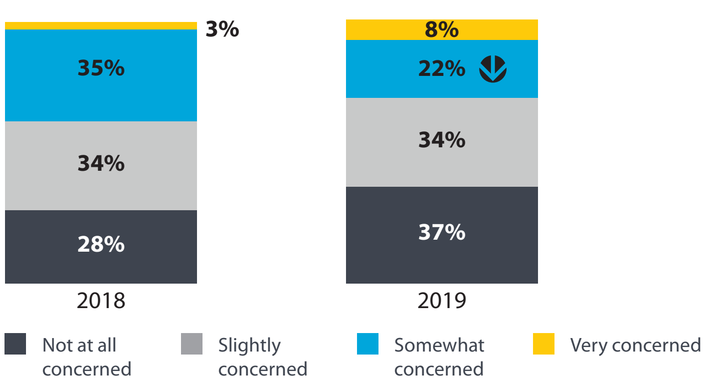
Base: Total respondents - 441 in 2019, and 312 in 2018

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



Up/down arrows denote a significant difference from 2018 at the 95% confidence level.
Base: Respondents who were aware of the pending changes to accounting rules relating to leasing: 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?



Up/down arrows denote a significant difference from 2018 at the 95% confidence level.
Base: Respondents who were aware of the pending changes to accounting rules relating to leasing - 204 in 2019, and 149 in 2018

Which of these factors poses the **greatest risk** to the U.S. construction industry in 2019?

Top answer % (Ranked 1st)	2019
Availability of qualified workers	36%
Rising interest rates	17%
Economic uncertainty	16%
Political/regulatory uncertainty	13%
Rising material costs	5%
The residential construction market	4%
Energy prices such as oil and natural gas	3%
The nonresidential construction market	3%
Tariffs	3%
Other	1%

Base: Total respondents – 441 in 2019.
Note: No previous data is shown due to changes to Q26 in 2018.

Far above other factors, the low availability of qualified workers rose to the top as the greatest risk to the industry for 2019. Many employers are feeling the pinch of not having qualified workers. Rising interest rates and economic uncertainty also rose to the top of the list. Some respondents expanded on these risks in their own words and their responses to the open-ended questions we asked in the survey are printed throughout this booklet.

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

Top answer % (Ranked 1st)	2019
Improved national economic situation	18%
Increased consumer confidence	14%
Increased government spending	13%
Improved local economic situation	11%
Improved political climate	9%
Private investment	9%
Stable regulatory environment	7%
The residential construction market	7%
The nonresidential construction market	6%
Improved financial condition of state and local agencies	6%
Other	*

* Total responses amount to less than 1%.
Base: Total respondents – 441 in 2019.

For the last six years, executives believe that improving the national economic situation would create the greatest opportunity for growth in the construction industry with 18% reporting it is their top opportunity. Increased consumer confidence took second place this year with 14% of executives stating it is one of the top opportunities for growth in the next year. Increased government spending and an improved local economic situation 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)	2019
Tax reforms/tax incentives	36%
Highway Funding Bill	33%
Affordable Care Act	9%
Tier IV emission standards	9%
Gas tax	4%
Debt ceiling	4%
Hours of Service (HOS)	4%
Other	1%

Note: no previous data is shown due to changes in Q30 in 2018.
Base: 441 in 2019.

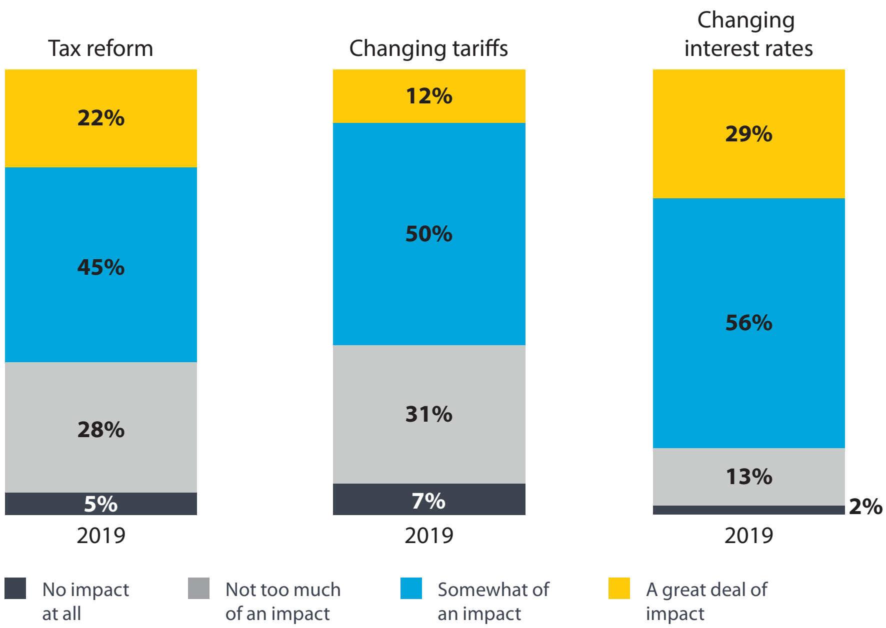
Tax reforms/tax incentives (36%) and the Highway Funding Bill (33%) are the greatest regulatory issues of interest for executives.

The Affordable Care Act and Tier IV emission standards tied for third place as a top regulatory issue.

Tax reform, tariffs, and interest rates

Generally, tax reform, changing tariffs, and changing interest rates are expected to have somewhat to a great deal of impact on businesses. Distributors are more likely to feel that tax reform, changing tariffs, and interest rates will have an impact on business in 2019. Larger companies (those with +$25M in revenue and those with more than 50 employees) are more likely than smaller companies to feel that tax reform and changing tariffs will have an impact on their business.

What **impact**, if any, do the following have on your business in 2019?



Base: 441 in 2019.

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Business Strategy

Ranking Concerns of Contractors and Distributors

The ability to hire qualified workers (47%), and employee wages and other benefits (11%) ranked as contractors' top cost concerns. Meanwhile, increasing concerns over equipment costs (26%) and financing costs (23%) for distributors remained top concerns. Interestingly, distributors' concerns over financing costs rose dramatically from 8% in 2018 to 23% in 2019, and concerns about taxes decreased significantly from 15% in 2018 to just 4% in 2019.

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

Top concern % (Ranked 1st)	2019
Ability to hire qualified workers	47%
Employee wages and other benefits	11%
Healthcare costs	10%**
Materials costs	8%
Equipment purchase costs	7%
Interest rates	6%
Fuel costs	5%
Taxes	5%
Equipment rental costs	*
Other	1%

* Total responses amount to less than 1%.

** 46% of contractors surveyed have more than 50 employees, implying they have health insurance for employees.

Base: Total contractors – 262 in 2019
Note: No previous data is shown due to changes to Q13b in 2018.

The top cost-category concerns among contractors have shifted for 2019. The ability to hire qualified workers rose to the top as a concern among contractors. Similar to 2018, employee wages and healthcare costs are still a top concern. Since 46% of contractors surveyed have more than 50 employees, this implies they are carrying healthcare for their employees. Employee wages and the cost of providing benefits have been consistent concerns over the years.

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

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

Up/down arrows denote a significant difference from 2018 at the 95% confidence level.
Base: Total distributors and rental companies – 127 in 2019, 105 in 2018, 134 in 2017, 174 in 2016, and 138 in 2015
Note: In 2019, distributors were not asked to rank the cost impact of the ability to hire qualified workers.

Equipment, financing and employee wages/other benefits costs are the most concerning to distributors. Concern for equipment costs rose from 20% in 2018 to 26% in 2019. Concern for financing costs sharply increased in 2019 from 8% in 2018 to 23% in 2019. Concern over employee wages and other benefits also rose. Concern over taxes sharply decreased from 15% in 2018 to just 4% in 2019.

WHAT WILL CHANGE THE INDUSTRY IN THE FUTURE?
WHAT WILL BE THE FACTORS THAT WILL DRIVE CHANGE?

"Technology will eliminate the need for unskilled labor. More white-collar jobs will be created to support the technology. Bottom lines will not improve, but total throughput will. Firms that don't invest in tech will be eliminated."

— SURVEY RESPONDENT

THINKING ABOUT THE STATE OF YOUR BUSINESS, WHAT CONCERNS DO YOU HAVE? WHAT DO YOU BELIEVE WILL BE HAPPENING IN THE INDUSTRY IN 2019?

"Industry lacks labor resources to complete work."

— SURVEY RESPONDENT

WHAT WILL CHANGE THE INDUSTRY IN THE FUTURE? WHAT WILL BE THE FACTORS THAT WILL DRIVE CHANGE?

"We will need to attract more young people to the industry."

— SURVEY RESPONDENT

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 $48.9 billion in assets under management,[1] more than 314,000 customers, and 2,500 team members.[2]

Construction equipment financing

We have deep expertise 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 meet their financial needs and WFEF is a leading provider that offers complete, creative 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.

THINKING ABOUT THE STATE OF YOUR BUSINESS, WHAT CONCERNS DO YOU HAVE? WHAT DO YOU BELIEVE WILL BE HAPPENING IN THE INDUSTRY IN 2019?

"The industry will continue to do well in 2019. Our biggest threat will continue to be lack of workforce interested in the construction equipment industry."

— SURVEY RESPONDENT

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

[1] 2018 Monitor 100.
[2] Company data as of June 2018.

How does 2019 look for the construction industry?

For the 43rd year, Wells Fargo has surveyed executives nationwide to find out. See their predictions inside this 2019 Construction Industry Forecast.

- Industry optimism — is an expansion or contraction more likely?
- Trends in the rental market — are distributors increasing fleet sizes and are contractors planning to rent in 2019?
- Equipment purchase intentions — what is the outlook for new and used equipment purchases in 2019?
- Net profit expectations — how do expectations for net profits align with industry optimism and purchase intentions?
- Impacts of tariffs and interest rates — how do these topical issues impact individual businesses?
- Top cost concerns — what do industry executives say are their biggest concerns in 2019?

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