

# The Industry That Time Forgot

What's wrong with the \$1 trillion construction business?

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presented to the

**The Information Technology & Innovation Foundation**

presented by

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Based on his new book,

***Broken Buildings, Busted Budgets:***

*How to Fix America's Trillion-Dollar Construction Industry*

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# The Industry That Time Forgot

What's wrong with the \$1 trillion construction business?

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**The Importance of Construction**

**How an Inefficient Industry Operates**

**Rebalancing the Industry**

**The Challenge Ahead**



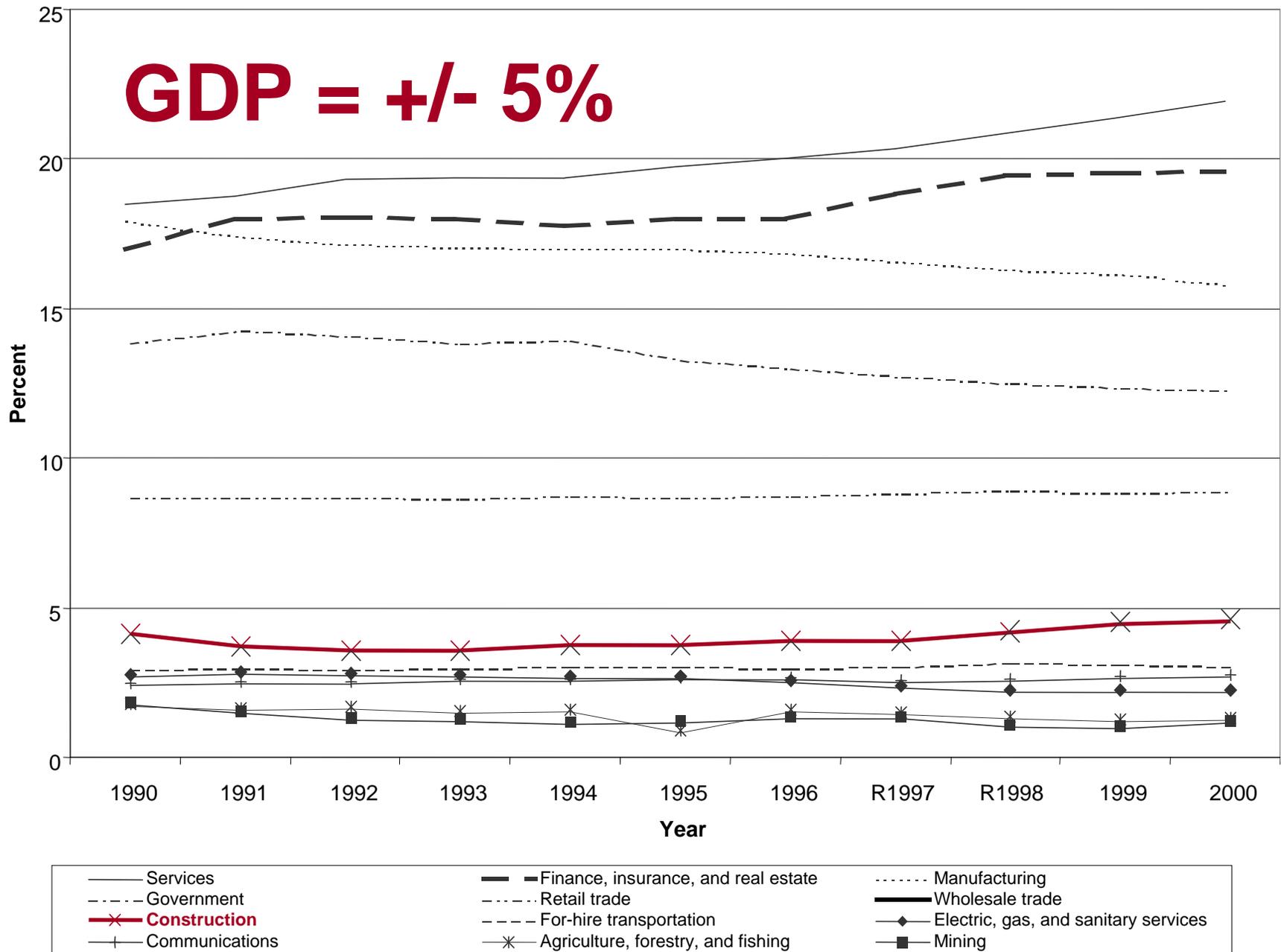
The inefficiencies of the construction industry cost our nation's taxpayers, corporations and developers over \$120 billion annually.

**The pervasive cost overruns that impact almost every project, are the result of:**

- a fragmented industry
- no truly national firms
- limited cash flow
- minimal capitalization
- inability to accept risk
- uneducated owners
- incomplete designs

# Importance of the Construction Industry

Contributions to Total GDP by Industry, 1990-2000



# Importance of the Construction Industry

**\$1.23 trillion** spent annually

# Importance of the Construction Industry

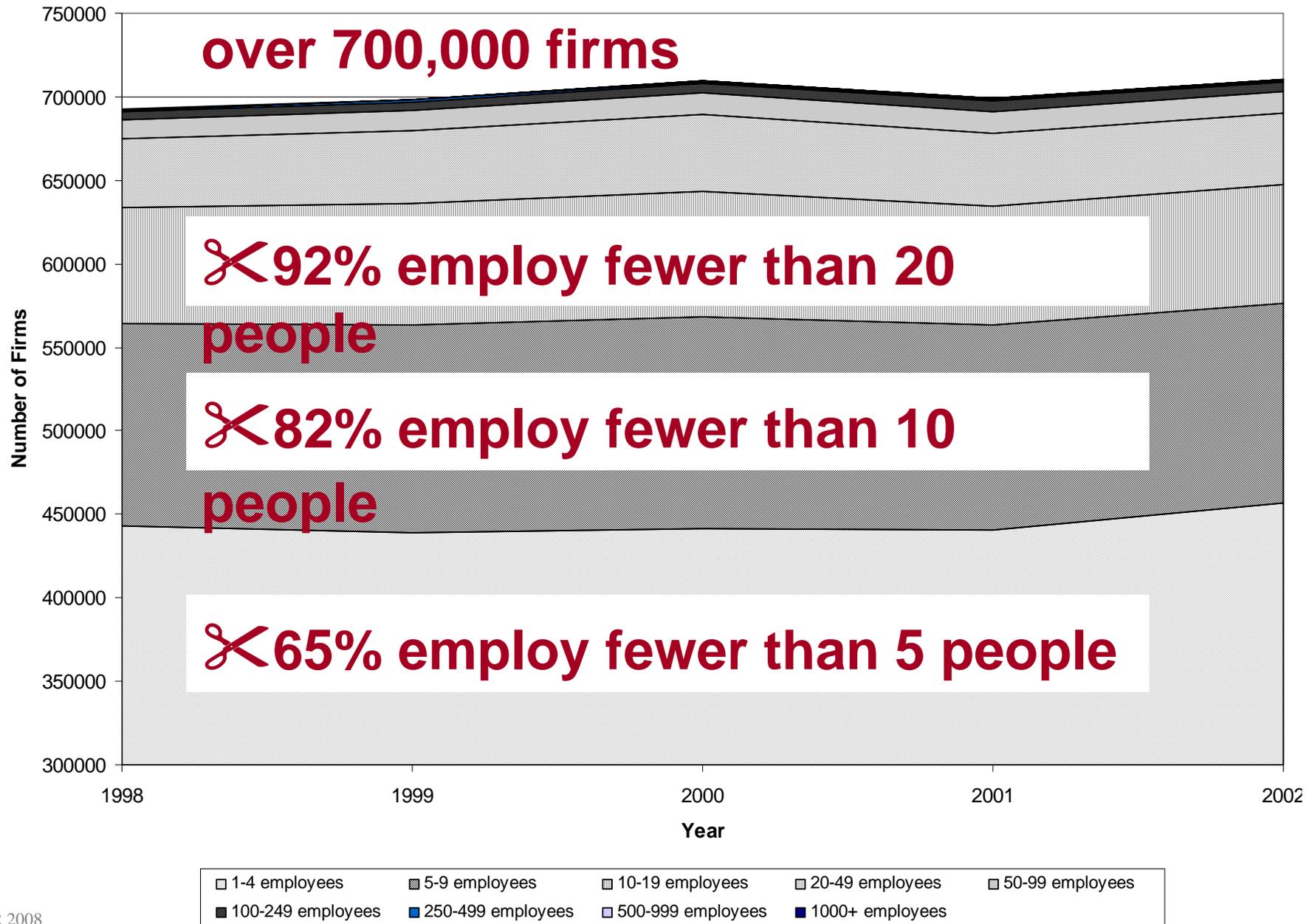


**over 7.6 million**

**individuals employed in the industry...**

# Importance of the Construction Industry

## It is the last 'mom & pop' industry





## National Construction Trends

A recent **Brookings Institution** report predicts:

- **by 2030, the U.S. population will increase by 70 million;**
- **427 billion sq. ft of new building stock will be needed to serve our growing population of which 100 billion sq.ft. of new residential space will be required;**
- **By 2030, half of all buildings will have been built after 2007.**

## National Construction Trends

We are in the middle of an unprecedented \$25 trillion building boom of buildings, infrastructure, and homes.

In NYC we spent over \$26 billion in 2007 and will spend over \$83 billion by 2010.

## National Construction Trends

Contractors are unable to find experienced supervisors and project managers. As a result, salaries are escalating.

In addition, labor costs rose 5% in 2007 and will rise 4% in 2008 despite a slowing economy.

## How an Inefficient Industry Operates

When the construction industry's inefficiencies and risk-averse mentality adversely impact project budgets by 20%, 30%, or 100%, it damages the industry's reputation and credibility.

# Construction & Non-Farm Labor Productivity Index, 1964-2003

Source: U.S. Dept. of Commerce, Bureau of Labor Statistics

Constant \$ of contracts / work hours of hourly workers

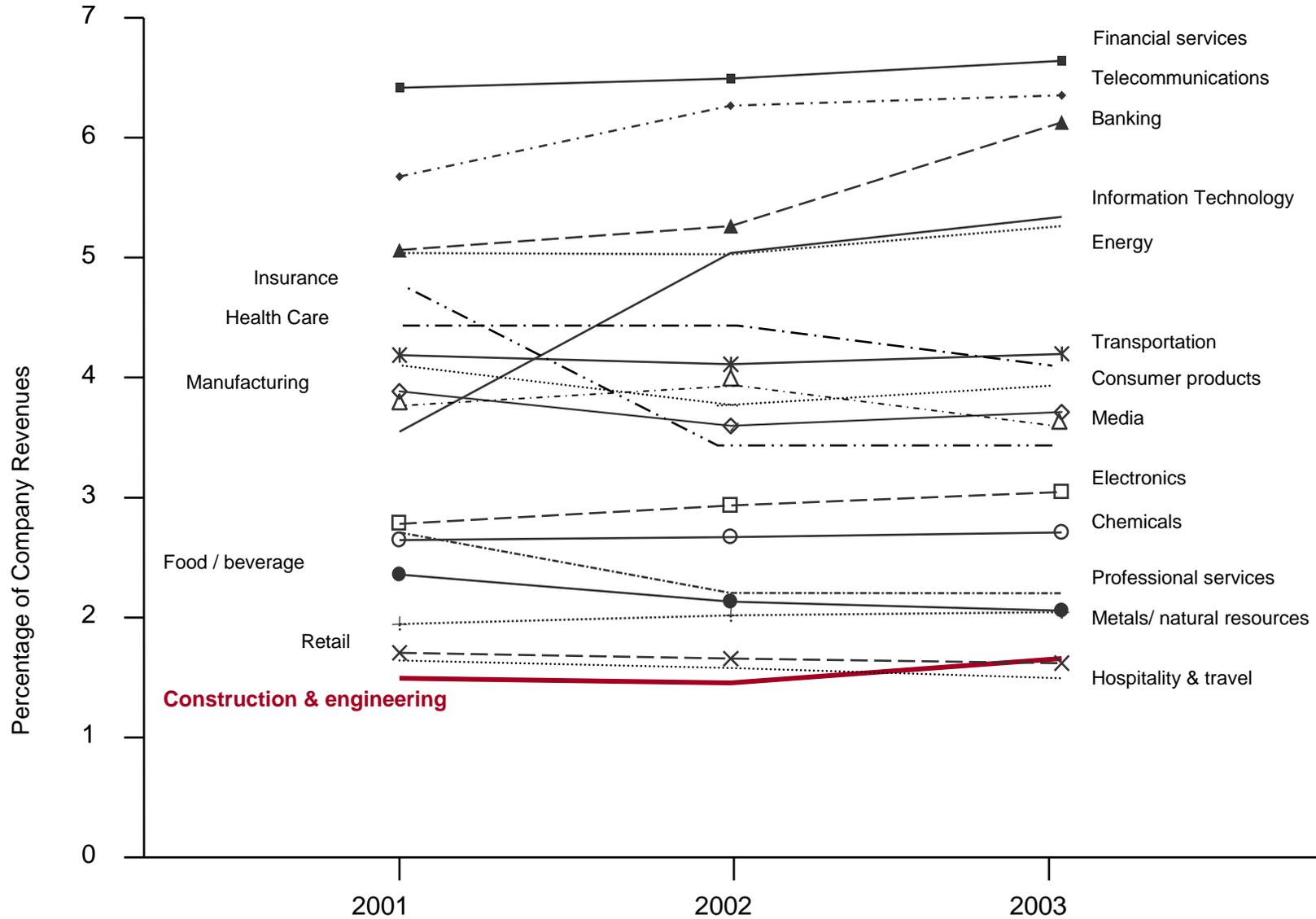
250% ..... **>125% increase**

***50% of labor costs are wasted  
due to contractor inefficiencies!***



# U.S. IT Spending by Industry, 2001-2003

Source: e-Marketer, 2003



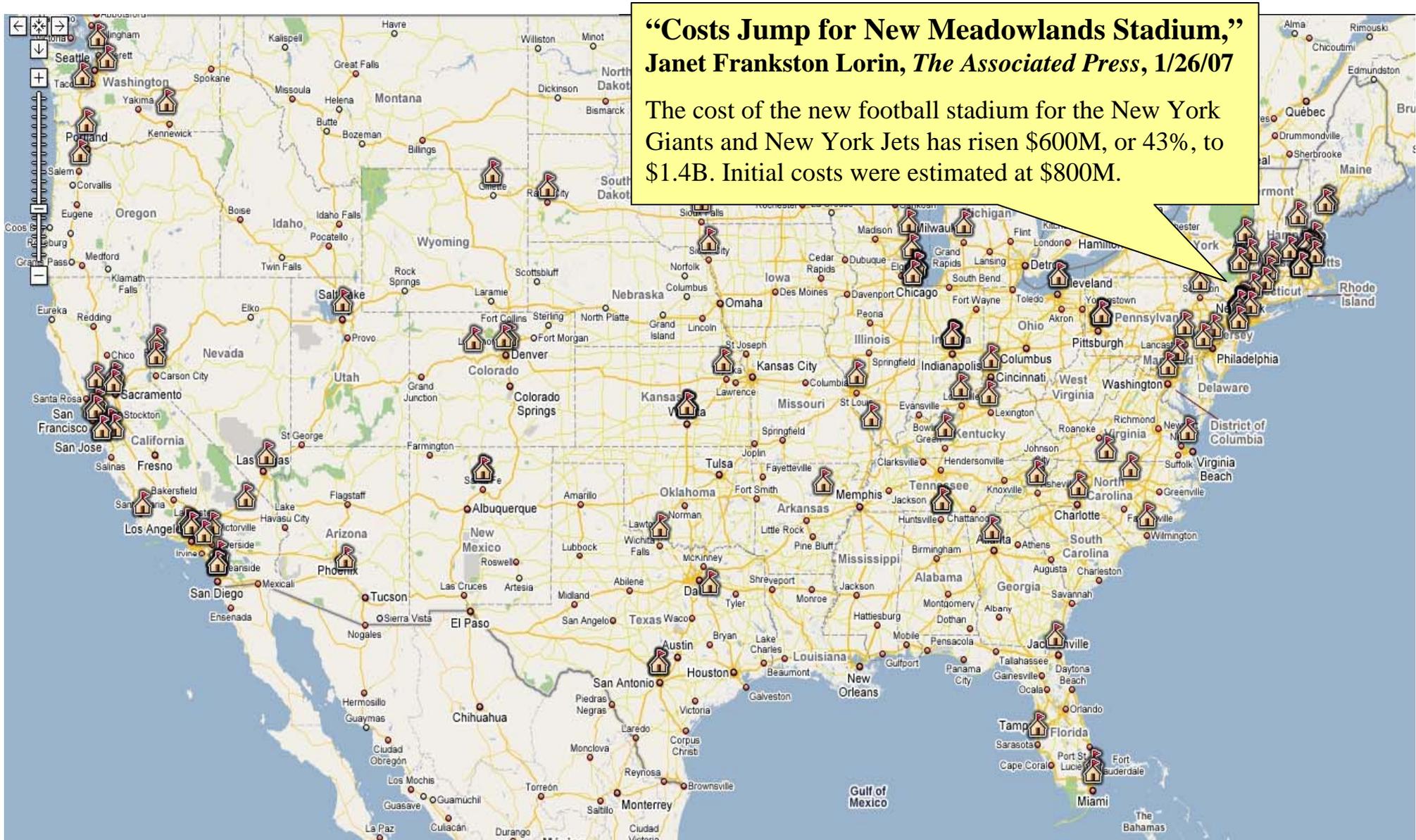
Construction cost overruns plague our economy.

**High-profile cost overrun headlines abound:**



**The Big Dig, Boston**

# Construction cost overruns plague our nation.



Visit [www.brokenbuildings.com](http://www.brokenbuildings.com) to view a small percentage of cost overrun headlines published every day.

An aerial night view of a city skyline, likely New York City, featuring several prominent skyscrapers illuminated with lights. The buildings are set against a dark, twilight sky. The lights from the buildings and streets create a vibrant, glowing effect. The text is overlaid on the lower portion of the image.

**Adding to the national concern of cost overruns are new global realities that will substantially increase construction costs in the years ahead.**

## Global issues affecting construction:



By 2030, worldwide urbanization and migration from the countryside to cities will result in **23** new cities of over 10 million people.

## Global issues affecting construction:

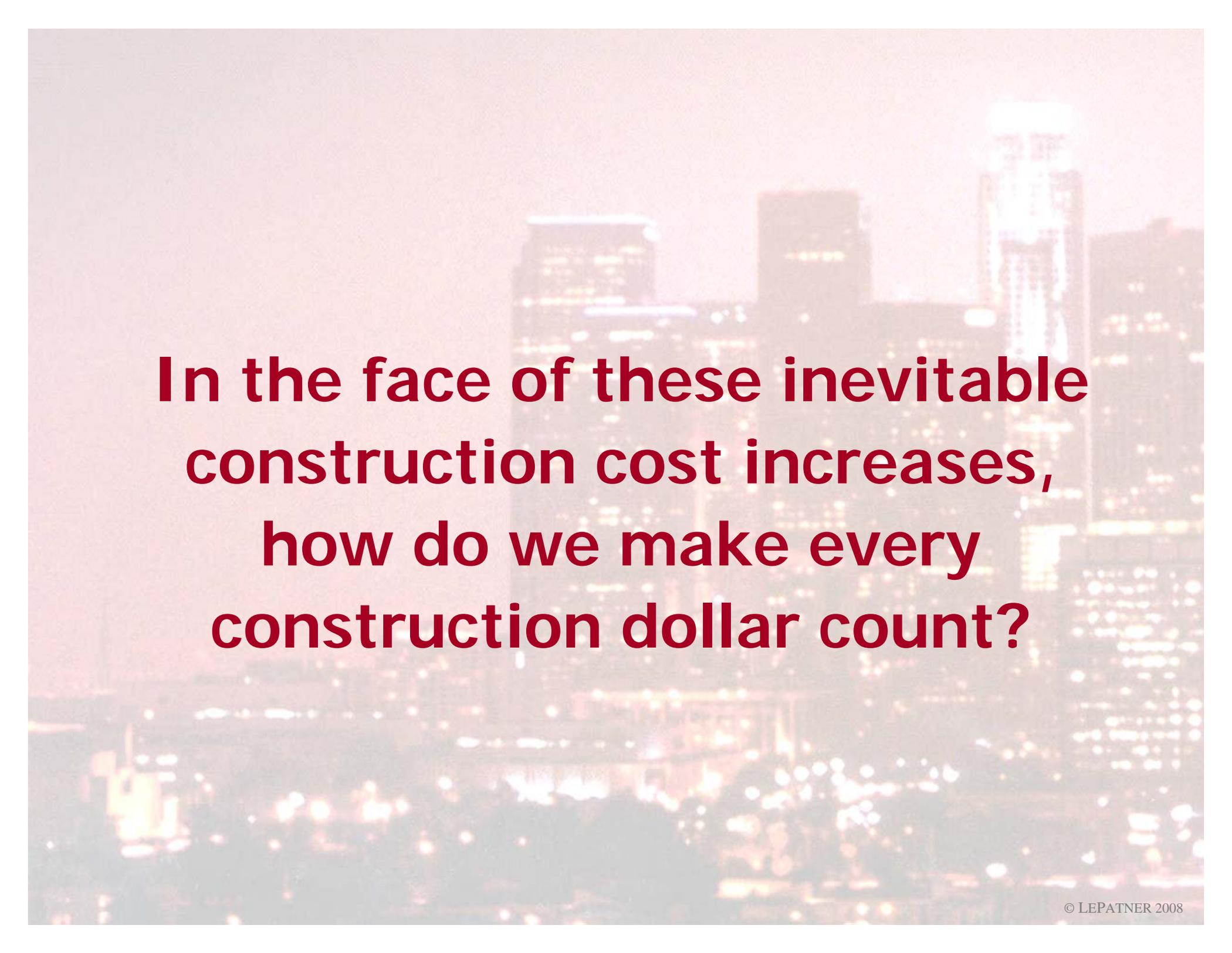


**As demand for natural and manufactured materials continues to increase from China, India, Indonesia, the Middle East and Latin America, costs for U.S. buildings will continue to rise.**

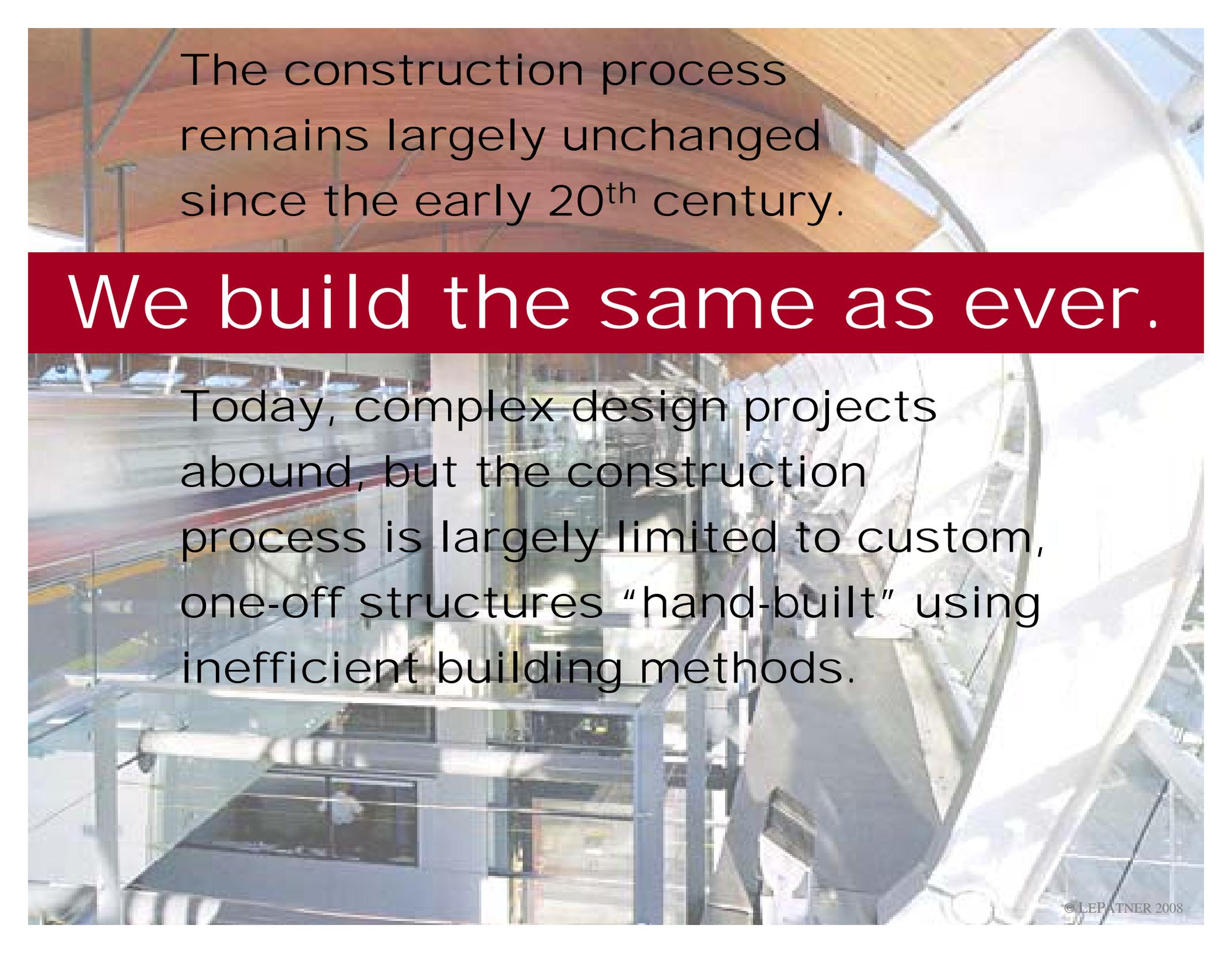
## Global issues affecting construction:



The U.S., for the first time, will compete globally for increasingly scarce building resources **such as steel, concrete, asphalt, and in the near future, water.**



**In the face of these inevitable  
construction cost increases,  
how do we make every  
construction dollar count?**



The construction process remains largely unchanged since the early 20<sup>th</sup> century.

**We build the same as ever.**

Today, complex design projects abound, but the construction process is largely limited to custom, one-off structures “hand-built” using inefficient building methods.

# How an Inefficient Industry Operates

## The Equation of Industry Failure

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High levels of asymmetric information favor the Contractor + Lack of effective intermediaries for the Owner  $\neq$  Fixed price contract





Why should our nation  
pay such a high price  
for a broken industry's  
deficiencies?

## How an Inefficient Industry Operates

**A contractor's worst nightmare:**

**THE WINNER'S CURSE**

## How an Inefficient Industry Operates

**The industry's reliance on the low-bid process forces contractors to make claims to make a profit.**

**Owners have accepted certain myths and illusions about the industry because “it’s the way it’s always been done.”**

Owners often believe:

- information on costs is transparent and freely available;
- there is a rational progression to the construction process;
- the construction documents provide all the information needed for contractors to establish a true, fixed price;
- there will be a reliable schedule;
- risks will be fairly allocated to each party; and
- though they bear the largest risk and pay all the money, they will be in control of the process.

These are myths.

# The reality favors contractors:

An owner is rarely sophisticated enough to fully grasp critical **construction business issues**.  
The resulting negotiation is often one-sided.

The **contractor controls all critical information** regarding prices for materials, labor and equipment.

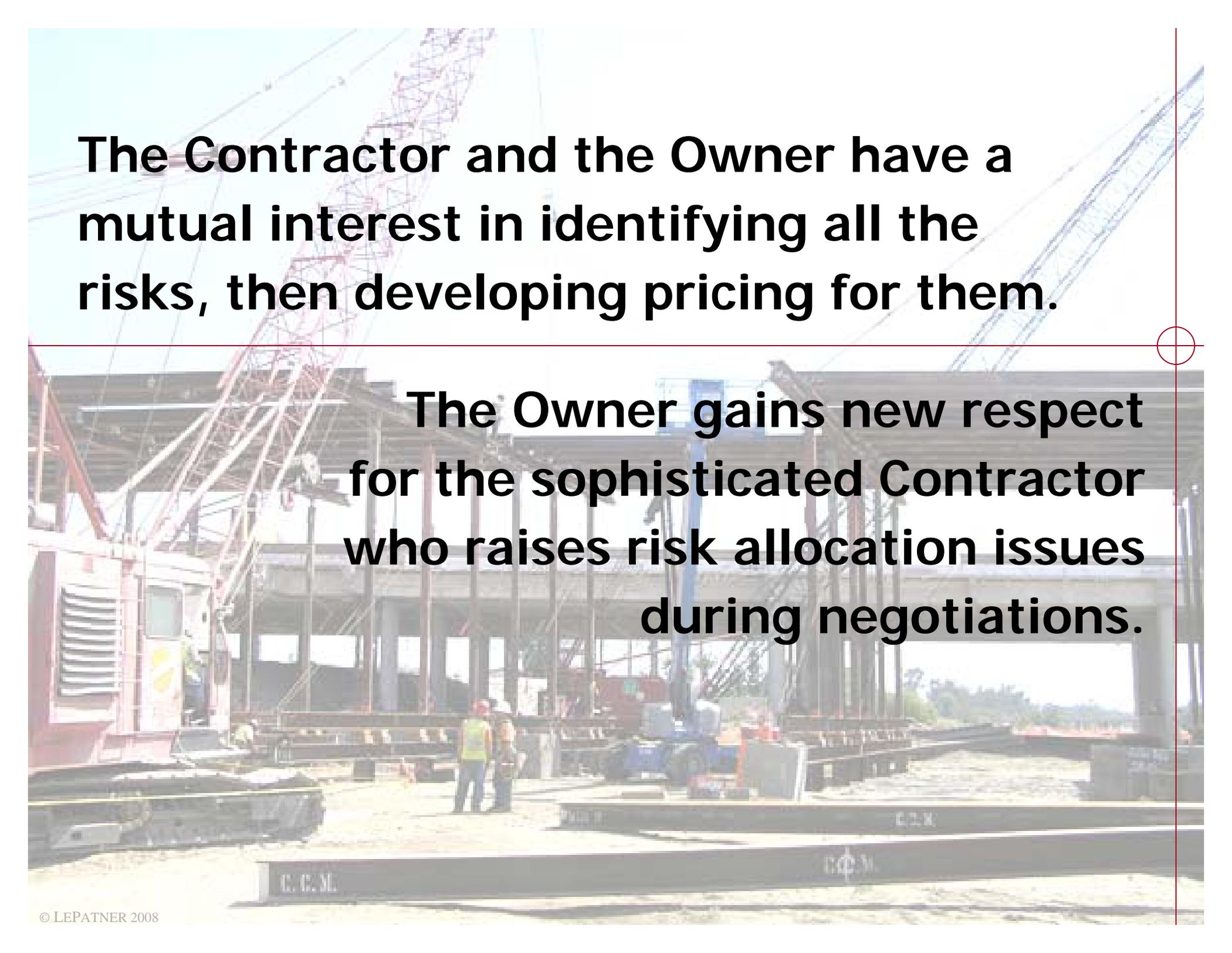
Once a standard form contract is executed, the **contractor assumes monopoly power** over the project.

# Rebalancing the Industry benefits all

## An Equation for Reform:

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True risk allocation + Effective intermediaries = True, fixed-price contracts based on 100% complete & coordinated CDs for **BIDDING**.

A large-scale construction site with multiple cranes and a partially completed building structure. The scene is filled with steel beams, concrete foundations, and various construction equipment. The background shows a clear sky and some distant trees.

**The Contractor and the Owner have a mutual interest in identifying all the risks, then developing pricing for them.**

**The Owner gains new respect for the sophisticated Contractor who raises risk allocation issues during negotiations.**

# The Owner and Contractor should convene a risk allocation meeting to negotiate responsibility for:

- scheduling and coordination of the subcontractors;
- fast-track construction schedules;
- incomplete CDs and errors and omissions in the design
- timeliness of governmental approvals and permits;
- timeliness of owners' payments and decisions;
- weather-related delays;
- concealed existing and subsurface conditions;
- material and labor escalation during the project;
- delivery delays, especially from long-lead and overseas items;
- securing adequate insurance and bond coverage;
- financial impacts and carrying costs due to delays; and
- liens, claims and lawsuits.



# THE CHALLENGE AHEAD



Following upon major construction-related disasters, the nation is poised to embark on unanticipated remedial infrastructure work that will cost our nation **\$1.6 trillion.**

Turning this amount of funding over to an unreformed construction industry without tightened controls would be a **financial disaster.**

How do we mitigate budget overruns?



**Every construction dollar  
must be spent wisely.**

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The issues discussed today are further detailed in *Broken Buildings, Busted Budgets*, published by The University of Chicago Press.

[www.brokenbuildings.com](http://www.brokenbuildings.com).

