The Industry That Time Forgot

What’s wrong with the $1 trillion construction business?

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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?

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

GDP = +/- 5%
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

- Over 700,000 firms
- 92% employ fewer than 20 people
- 82% employ fewer than 10 people
- 65% employ fewer than 5 people
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.
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.
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

Constant $ of contracts / work hours of hourly workers

>125% increase

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

>20% decrease

Construction Productivity Index (1964 = 100%)
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.


The cost of the new football stadium for the New York Giants and New York Jets has risen $600M, or 43%, to $1.4B. Initial costs were estimated at $800M.

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

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

We build the same as ever.
How an Inefficient Industry Operates

The Equation of Industry Failure

High levels of asymmetric information favor the Contractor + Lack of effective intermediaries for the Owner ≠ 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:

True risk allocation + Effective intermediaries = True, fixed-price contracts based on 100% complete & coordinated CDs for BIDDING.
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.
The issues discussed today are further detailed in *Broken Buildings, Busted Budgets*, published by The University of Chicago Press.