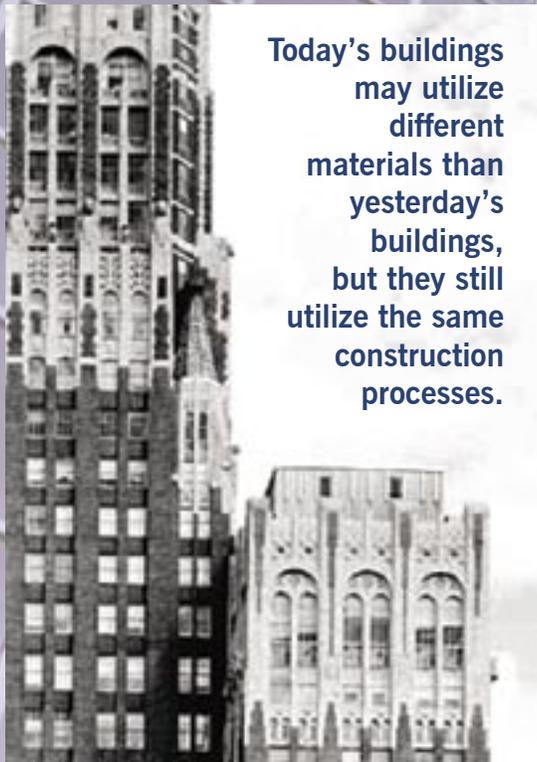


## Our Dysfunctional Construction Industry: HOW DID IT EVER GET TO THIS?

By Barry B. LePatner, Esq.

*The following article is excerpted from Barry B. LePatner's forthcoming book, **Broken Building, Busted Budgets: How to Keep the Construction Industry from Wrecking Your Organization's Fiscal Foundation**, to be published by the University of Chicago Press in 2007. With more than \$1.1 trillion spent annually, the construction industry possesses the lowest productivity of any U.S. industry. Some 40-60% of all construction dollars spent by an owner never get spent on the project. This book hopes to start a national debate on how to modernize an antiquated industry.*



**Today's buildings may utilize different materials than yesterday's buildings, but they still utilize the same construction processes.**

**T**he modern buildings crowding our city skylines today look and feel different than the buildings of the late nineteenth century. Looks can deceive however. The process by which today's buildings are actually designed and constructed is one that the developers, architects and contractors of the past would find instantly familiar. Buildings may be taller, more transparent, and filled with sophisticated electrical and mechanical systems than those of 50 and 100 years ago, but the way we build them has hardly changed at all.

For the construction industry, the disjuncture between product and process poses problems of control and performance. Ongoing debate over construction industry productivity is symptomatic. It is not surprising that industry productivity should have declined absolutely or at least badly lagged behind other sectors over the last forty years (the period for which good data are available) – not an insignificant drag given the industry's size at 5 percent of total GDP. Scholarly and industry argument swirls here, particularly over how best to measure construction output. But consensus, statistical and anecdotal evidence, is broad and deep that this huge industry does not perform as it should. The men and women who work in this industry every day, year after year, at every level, know this instinctively. No one denies it. Everyone wants to do better.

The industry must do better. In some form or another, be it public buildings and infrastructure, corporate edifices or mere home remodeling, the construction industry has a significant presence in every U.S. city, town and community. It is known that by January 2006, construction was a \$1.16 trillion a year industry in the U.S. A one-time improvement in construction productivity of 10 percent would boost America's GDP by \$116 billion. That sum, compounded annually at 3 percent for 30 years, would mean a real per capita income over \$273 billion higher in 2037 than if the construction industry remains unreformed. Put another way, reform could generate economic growth of sufficient magnitude to save Social Security as it is currently constituted (but that is the subject of another book.)

Higher construction productivity would improve construction and lower construction costs. Improving construction would lead to safer buildings and infrastructure. Higher productivity could also lead to better construction quality in general. Indirectly, lower construction costs could trickle down to lower rents and/or increase profits and stimulate demand and increased consumer confidence and satisfaction in the building process. The potential benefits for not only the construction industry but for the nation's economic health are potentially enormous.

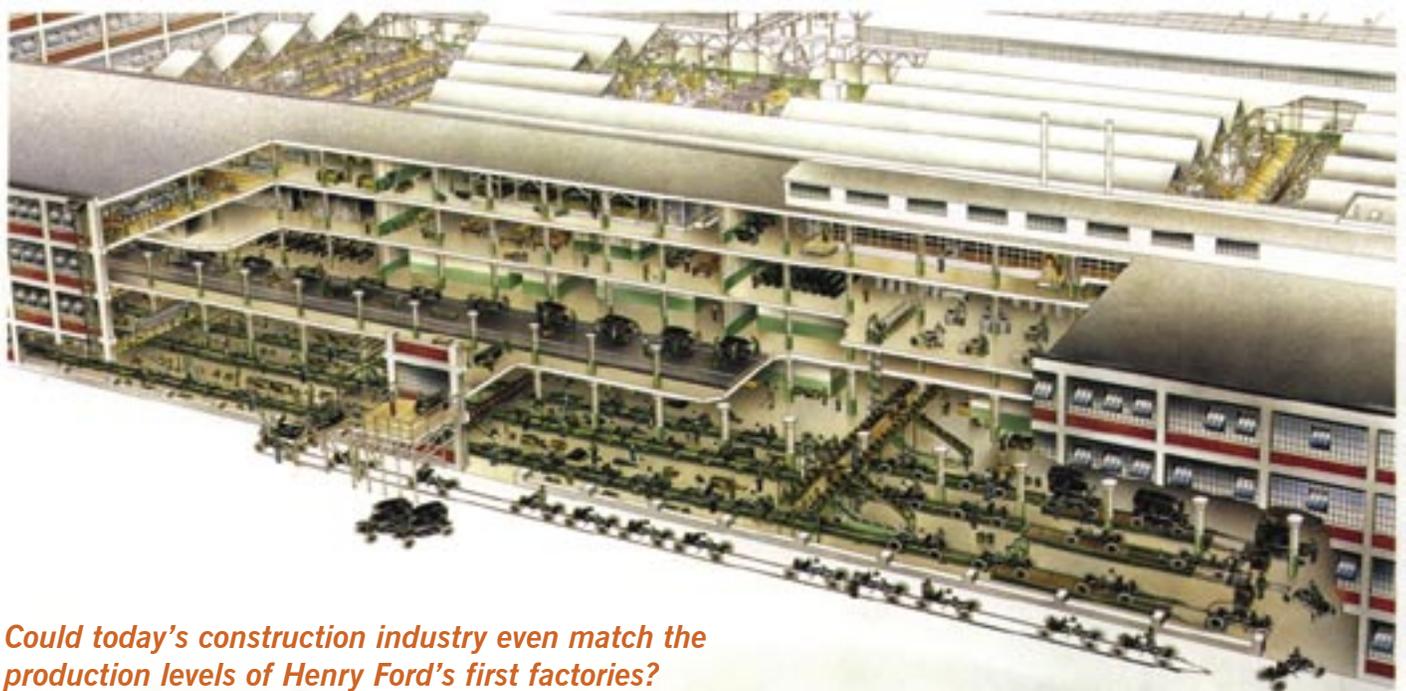
#### How did the construction industry fall behind?

In the early twentieth century, the advent of integrated manufacturing processes, such as those pioneered by Henry Ford, spread widely to many industries, lowering costs to consumers while paying investors good returns. Only one enormous industry missed out. Construction resisted mass produc-

tion techniques, and to this day its products remain largely hand-made. Its largest projects are typically, and by design, unique one-offs. Even though countless items and tasks that comprise every commercial and residential building are commonly-used and standardized – electrical conduit, plumbing pipe, sheetrock and steel framing, flooring – the skilled specialized contractors that must coordinate to construct a building today are seldom the same contractors to construct a building right across the street six months from now. Even the ubiquitous McDonald's, with its standardized restaurant design, finds itself utilizing different contractors in each location, let alone region of the country.

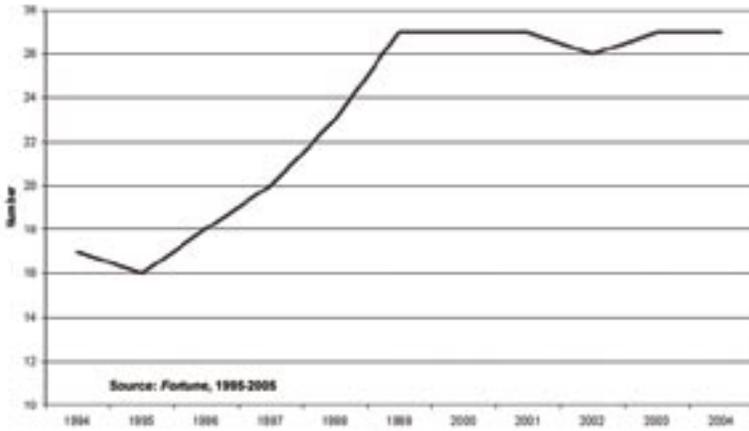
While the construction industry long ago embraced many of the technological products of industrialism – elevators, air-conditioning – it has not embraced industrialism's primary organizational form: the structurally and strategically integrated, professionally-managed business corporation. The construction industry remains fragmented locally and regionally. Its firms are often small with few principals at the helm, or they are often family-owned. Even those few large construction firms with a national presence pale in size to a typical non-construction-oriented national corporation. Outside investors show little interest in consolidating the historically insular construction industry.

Of all our nation's large industries, why has only construction spurned innovation and remained static in the means it employs to deliver its finished product? Is it intentional that so little progress has been made in the design and construction world? How did the capital markets ignore the seemingly straightforward endlessly growing business of building? Is the industry inherently unprofitable or risky?



**Could today's construction industry even match the production levels of Henry Ford's first factories?**

Number of Engineering and Construction Companies in the Fortune 1000



Has anyone proven that consolidation could not yield better returns? Or is there not opportunity here for today's far-seeing investor?

**The Means of Control: Getting More for Less**

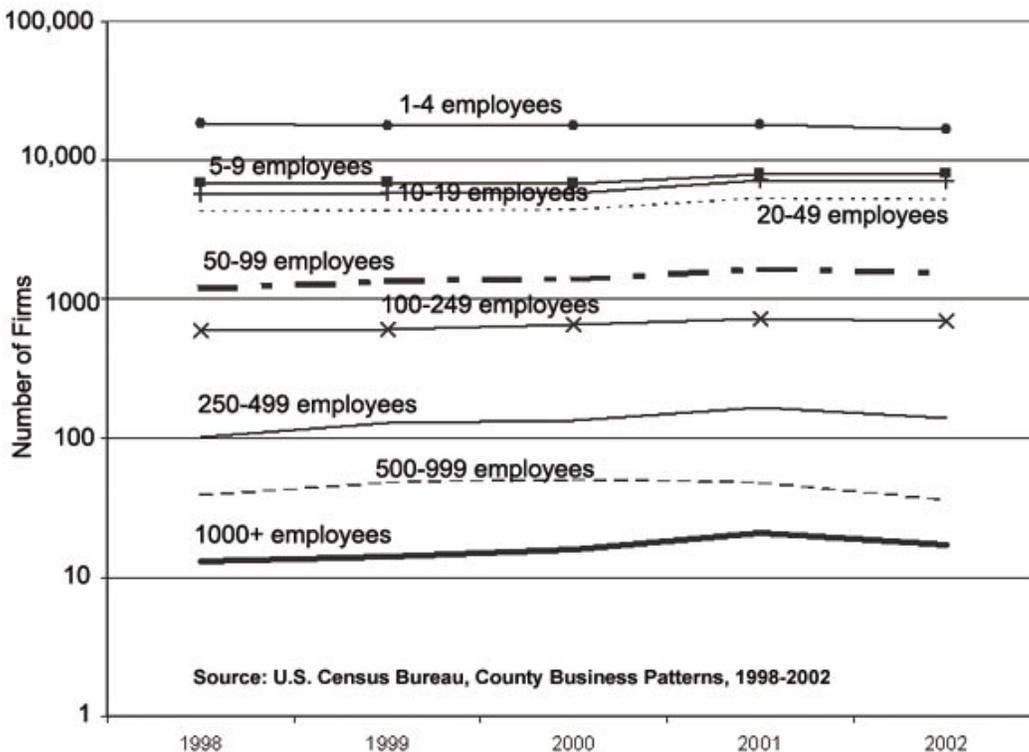
How then does a fragmented trillion-dollar industry, rusty with historical inefficiencies and beset with low productivity and distorted risks, shake off its lethargy and become an energetic agent for change? What will it take to persuade thousands of essentially local groups of small players to embrace technology, revamp management and reinvent themselves? There are examples in other industries.

Productivity in the U.S. Construction Industry, 1947-1979



Mass production and new technologies of the computerized world have enabled the automobile, entertainment, financial and other industries to operate more efficiently while they improve quality and reduce costs for consumers. Innovators like Henry Ford understood that integration of design and fabrication enabled more efficient manufacturing of automobiles. Insights and advances common to much of rest of the commercial world are still rare in construction. The very corporate headquarters buildings from which some of the country's most admired firms are directed, are the products of building techniques and business structures that would have no place at GE or Microsoft. Leadership is surely part of the problem. It is hard to think of a single nationally known spokesman for the architectural or construction world, which is not the same thing as celebrity architects who achieve renown in their own right.

Number and Size of Construction Firms in the U.S.



Similarly, there are no nationally positioned construction companies, which is not the same thing as merely being able to construct a project on a one-off basis in most major cities. Where, on the supply side, can be found the nationally-integrated construction and design firms to meet the demand for integrated professionally managed construction services? That is, where are the firms that can reliably deliver economies of scale, improved quality and lower costs? How is it possible to achieve control without integrated ownership (which is not likely to happen short term) given the existing constraints of project contracting, where no one authority owns all the assets or controls all the employees thus making it difficult to coordinate, coerce and fix problems or resolve disputes when they arise? (Unions, where present, play a role here and have self-defined interests in conflict with those of management.)

## What is the Future of the Construction Industry?

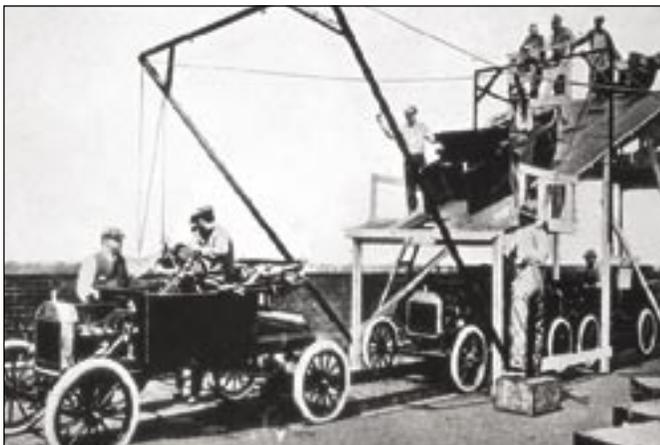
A consolidated and more productive industry is within reach. It is imperative to explore development of a national core of design and construction competencies, which, if properly assembled, would be attractive to the capital markets. Under such conditions, the possibilities intrigue. Venture firms that chose to consolidate local groups of architects, engineers and/or construction companies into integrated, adequately capitalized, professionally managed construction service providers, would not likely be disappointed in the return.

Before this can happen, however, the construction industry must address a fundamental market failure that cripples it today. Like many market failures, this one is characterized by a distressing and growing asymmetry of information between buyers (owners) and sellers (the construction industry). Such asymmetry poses obstacles to efficiency, which poses obstacles to improved profitability, which poses obstacles to industry consolidation. The public policy consequences of this market failure can be observed in inflated costs, which have become so routine within the system that both buyers (with resignation) and sellers (with satisfaction) appear to accept them as inevitable.

But the frustration and sense of inevitability should be neither inevitable nor acceptable. The recent disclosure to the public that the construction cost of the World Trade Center Memorial at Ground Zero had nearly doubled to \$1 billion in less than a year is only a small symptom of this universal problem. Owners must regain control of what they pay to build. The industry must design and build better. The country — the federal government, states, municipalities, public authorities — must at last, begin to spend its building dollars more wisely.

Look for more **Broken Building** excerpts in upcoming *LePatner Reports*. As always, we relish feedback. E-mail [blepatner@lepatner.com](mailto:blepatner@lepatner.com).

Below: Henry Ford's first assembly line. Right: the home-building industry has embraced some assembly-line production, but the rest of the construction industry has not made such progress.



# F I R M N E W S

## Real Estate Outlook 2006: Are We Entering A New Economic Cycle?

New York's corporate executives, real estate developers and design professionals will gather at LePatner & Associates' Fourth Annual **Secrets of the Expert Advisors** Executive Seminar Series at the University Club in midtown Manhattan on Thursday, June 8, 2006. **Real Estate Outlook: Are We Entering A New Economic Cycle?** is co-sponsored by The Rampart Group, Sterling National Bank, Berdon LLP and LePatner. **Barry LePatner** will moderate a panel that includes: **Rosemary Scanlon**, an associate professor of economics at NYU and a consultant in urban and regional economics; **John Powers**, chairman of the New York Tri-State Region of CB Richard Ellis; and **Stuart Match Suna**, co-owner and president of Silvercup Studios, which recently announced major development plans in Long Island City (see below). Look for full coverage of the event online at [www.lepatner.com](http://www.lepatner.com) and in the next LePatner Report.

LePatner is pleased to again represent London-based Lord Richard Rogers and his internationally renowned firm, **Richard Rogers Partnership** in contract negotiations for several important projects now underway in New York City including the \$1.8 billion Javits Convention Center Expansion, Tower 3 at the World Trade Center Site for Silverstein Properties, as well as a \$1 billion mixed-use development for the Queens-based television and film production company, Silvercup Studios. Plans call for two residential and one commercial tower, soundstages, retail and a riverfront esplanade to be built along the East River on a six-acre site next to the Queensborough Bridge.

LePatner is representing **The Andalex Group** as it develops its **Ariss Lofts** project, a 237-unit luxury condominium conversion of the former Eagle Electric headquarters at Court Square in Long Island City. LePatner drafted and negotiated the construction agreements and continues to act as construction counsel during construction.

LePatner is representing **Colgate Development LLC** on several major projects including 485 Fifth Avenue, a fashion-oriented luxury condominium in Manhattan, and a new 45-story luxury condominium tower in Philadelphia for Ritz-Carlton.

### QUOTE OF THE QUARTER

"I am all for progress;  
it is change I object to."

Mark Twain

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