WELLS FARGO

Wells Fargo Equipment Finance

Construction Industry Forecast

2016

The Optimism Quotient (OQ) — this survey's primary benchmark for measuring contractor and equipment distributor sentiment on local nonresidential construction activity — is 108 for 2016. Although overall optimism regarding construction activity remains very strong, it has declined since the 2015 record-high of 130. More executives expect 2016 will be consistent with 2015, and believe that construction activity will pick up in the fourth quarter of 2016, or later.

Together we'll go far

Photo courtesy of Stevenson Crane Service, Inc., Bolingbrook, IL.

"Our dealer partners continue to look towards rental to grow their business."

—Peter Gregory, Senior Vice President, Construction Group

"Despite challenges in Oil and Gas, our contractor clients see opportunity in infrastructure building."

— Jim Shewmaker, Vice President – Territory Manager, Construction Group

"Manufacturers are cautiously optimistic for the coming year."

— Roger Yost, Senior Vice President, Construction Group

A message from Wells Fargo Equipment Finance

We are pleased to present the annual Wells Fargo Construction Industry Forecast for the 40th year. The Forecast has proven to be a good indicator of the direction in which the construction industry is heading. It is a useful tool to determine the overall amount of work expected in the coming year, potential trends in equipment acquisitions, and the future level of expected rental activity.

This year, participation from survey respondents was up more than 15% from our 2015 Forecast, with the total number of unique responders approaching 500. Contractors, dealers, manufacturers, and industry suppliers were quite candid with their thoughts, revealing some clear trends.

The highlight of the Construction Industry Forecast is the annual Optimism Quotient (OQ). After reaching an all-time high in 2015, the industry OQ this year remains very positive at 108, although notably lower than last year's record. We consider any measurement higher than 100 highly positive. Taken independently, the result of 108 is the fifth highest recorded OQ in the past 20 years. However, it is only the fourth highest in the past five years, below those recorded in 2012, 2014, and 2015. The key ingredient to the OQ is whether the industry expects local nonresidential construction to increase, remain the same, or decrease. Compared to the 20-year horizon, 2016 could shape up to be very strong for the industry. Compared to the five-year trend, 2016 could be very positive, although with less enthusiasm about future trends. Remember, even if 2016 shapes up to be neutral, the baseline for comparison was strong to begin with.

One of the things that the industry is talking about this year is what is happening in the Energy space. We decided to do a comparison of "Energy states" (defined for purposes of this survey as states with Oil and Gas industries) standing alone versus the country as a whole, and found that at the time of the survey there wasn't a significant variance in outlook from those states.

In addition to the very positive 108 OQ, there are some notable highlights in the survey. We invite you to look through them and form your own opinions regarding the information. Some points worth considering are:

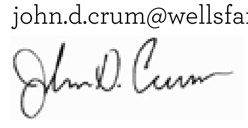
- Over a two-year period, most industry executives still believe that the industry will most likely expand, but they have some fear of a contraction as well.
- Executives believe that 2016 will be another positive year — 52% expect an increase in profits, although nearly the same number expect similar or declining profits.
- Lower fuel costs will benefit the industry: 91% of companies reported that they expect profits to increase because of lower fuel bills.
- The number of distributors who expect sales of new equipment to increase in 2016 slipped to 50%, while those who expect new equipment sales to remain the same as in 2015 jumped to 31%. Contractors seem to feel differently than distributors in this regard. The overall number of contractors who expect to increase new equipment purchases this year has increased to 42% from 34% in 2015.
- Distributors, who are coming off of a strong year in used equipment sales, believe this area of their business will remain steady to positive, while the percentage of those who are expecting used equipment sales to decrease has declined. Their contractor clients appear to agree with these expectations, similar to the previous year.
- On the rental side, overall rates would have to increase significantly to force contractors to buy instead of rent equipment in 2016. Fifty-two percent of contractors said that rental rates would have to increase by 15% or more before they would consider buying instead of renting. An additional 25% said rates would have to increase by 5% or more for this to occur.
- Equipment distributors expect to increase and maintain the size of their rental fleet in response to market demand: 40% expect to increase the size of the fleet, and 45% expect to maintain the size of their fleet.

These points bring some obvious questions to mind. Our top four are:

- Are we at a normalizing stage in the industry's recovery?
- Is there a disconnect between distributors and contractors on the expected amount of new equipment acquisitions?
- Are distributors being compensated adequately for their rental equipment, and is there room for improvement?
- What differences are there in the Energy states (Oil and Gas) versus the rest of the country?

We'd love to hear your thoughts on these topics. If you have a moment, give us a call at 1-866-726-4714 and we will be happy to discuss the forecast with you in more detail.

John Crum, National Sales Manager
Wells Fargo Equipment Finance
Construction Group
412-454-4629
john.d.crum@wellsfargo.com



Overview

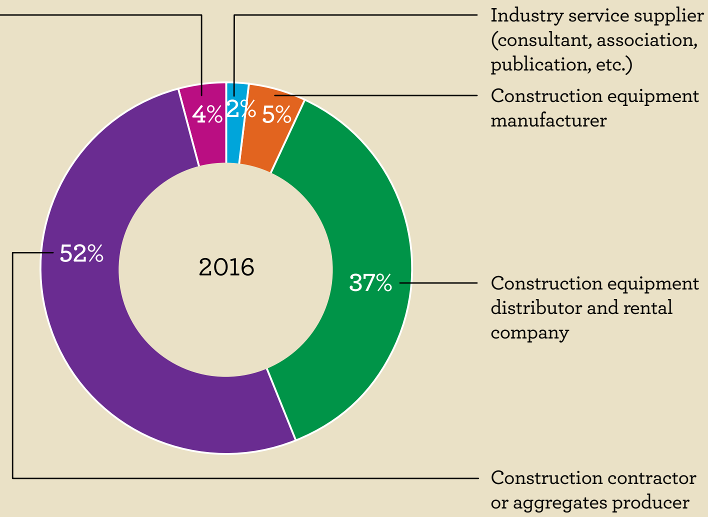
The survey results presented in this 2016 Construction Industry Forecast represent the 40th year in which Wells Fargo Equipment Finance and its predecessors have surveyed construction industry executives to gather insight into current business conditions and trends, and to measure their sentiment toward construction activity in the coming year. This year, survey responses came from 474 construction industry executives in 48 states. The margin of error is 4.5% (95% confidence level).

Survey dates

Survey dates Oct. 19 – Nov. 6, 2015

Composition of survey respondents

What best describes your 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.

Respondent classification

- **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
- **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
- **Equipment rental companies** acquire equipment to rent out to contractors
- **Manufacturers** create or build the equipment that contractors use

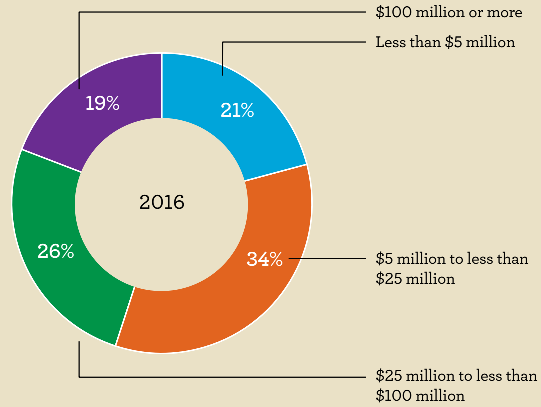
Photo courtesy of Cajun Industries, LLC, Baton Rouge, LA.

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

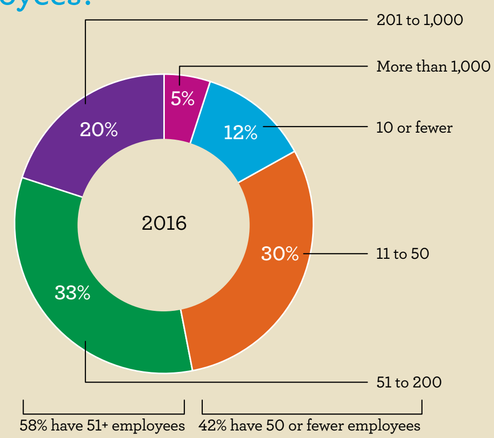
Category	2016
Site preparation and excavation	24%
Heavy highway	17%
Utility contracting	13%
Residential building	10%
Concrete and asphalt	9%
Nonresidential building	7%
Oil and gas	7%
Aggregates production and mining	8%
Bridges and overpasses	1%
Other	4%

Base: 248 contractor respondents

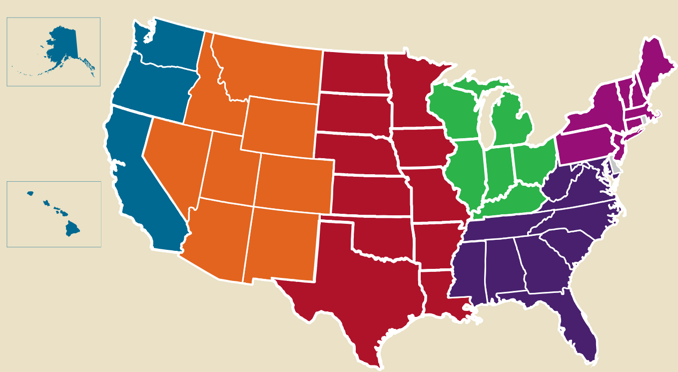
Which of the following categories best describes your company's annual revenue?

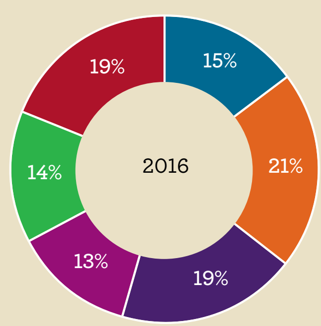


Which of the following categories best describes your company's total number of employees?



Geographic distribution of survey responses





Pacific
AK, CA, HI, OR, WA

Central
AR, IA, KS, LA, MN, MO, ND, NE, SD, OK, TX

Northeast
CT, ME, MA, NH, NJ, NY, PA, VT

Mountain
AZ, CO, ID, MT, NM, NV, UT, WY

Lakes
IL, IN, KY, MI, OH, WI

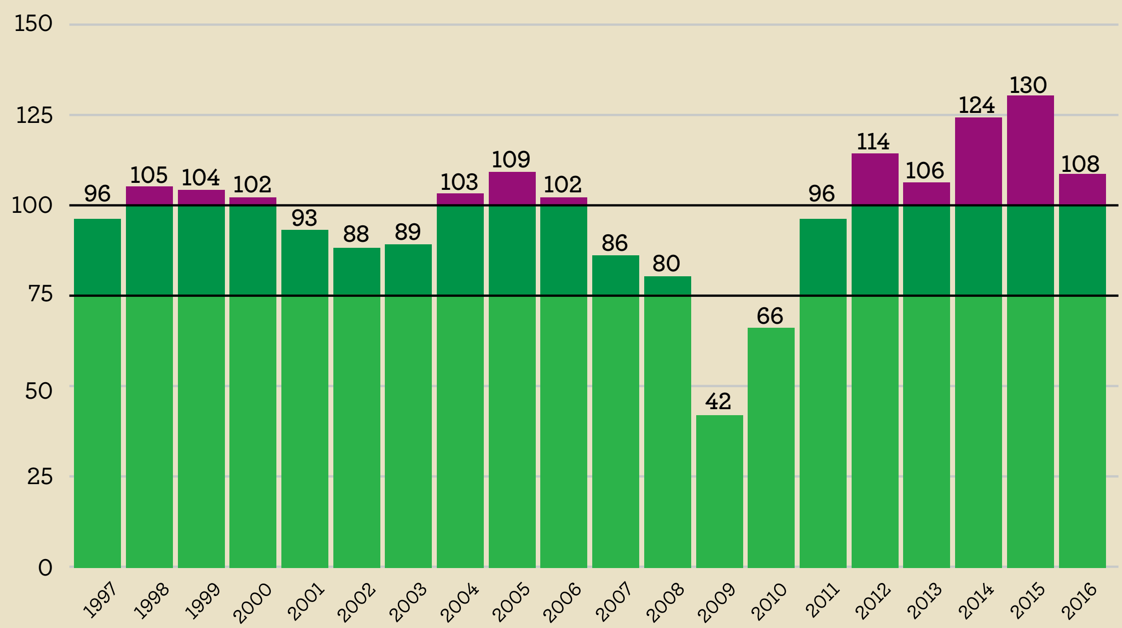
Southeast
AL, FL, GA, MD, MS, NC, SC, TN, VA, WV

Responses were received from 48 states. Responses from the Mountain states increased from 12% in 2015 to 21% in 2016. Delaware and Rhode Island were not included in the pool of respondents for 2016.

The Optimism Quotient

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 (OQ)



Base: Total respondents

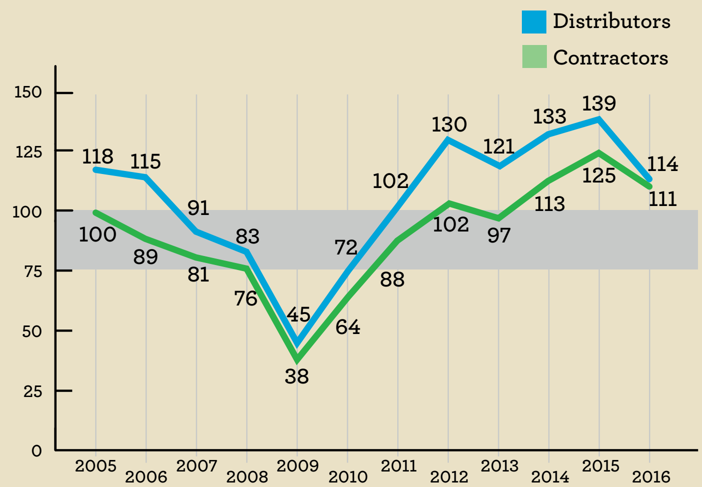
How to read the Wells Fargo Equipment Finance Optimism Quotient (OQ)

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.

The OQ for 2016 is positive at 108. After a pessimistic 2009 and 2010, OQ levels rebounded and have been holding steady with moderate optimism, even setting a record high in 2015. The industry this year remains very positive. Survey respondents across the U.S. expressed agreement that construction activity in their local areas will increase, perhaps in late 2016. It should be noted that the survey asks respondents about 2016 — a national election year — which could be influencing respondents' opinions of the year ahead.

Distributors and contractors

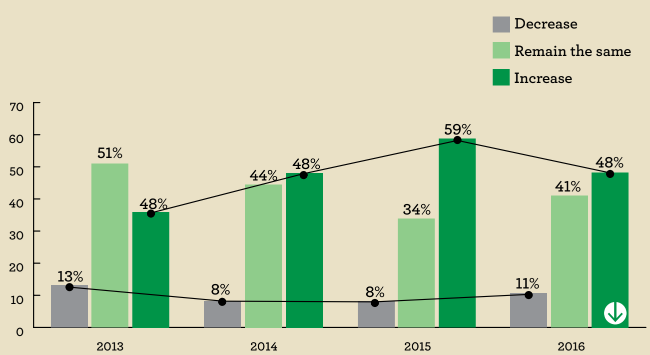
U.S. national Optimism Quotient



Base: Distributor and contractor respondents

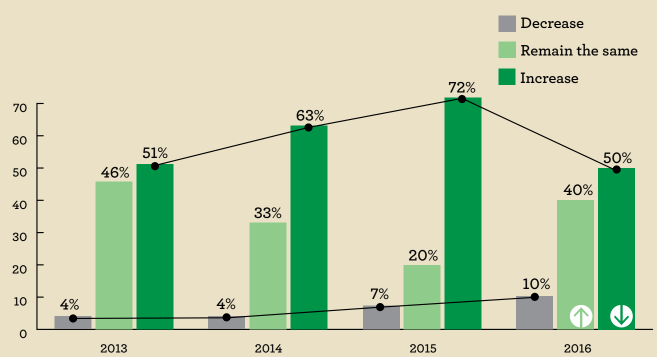
As this graph illustrates, distributors have historically been more optimistic about local construction activity than construction contractors. However, in the 2016 survey, the gap between those who buy construction equipment and those who sell construction equipment tightened and falls in line more closely with results we last saw in 2008 – 2010. Equipment manufacturers and other groups surveyed tend to be less optimistic than distributors and contractors, which brings the overall OQ down to 108 in 2016 as shown on the preceding page.

(Contractors) What is your projection for local **nonresidential** construction activity this year compared to last year?



Base: Total contractor respondents

(Distributors) What is your projection for local **nonresidential** construction activity this year compared to last year?



Base: 138 equipment distributor and rental company respondents

The up and down arrows indicate a real (statistically significant) change from 2015.

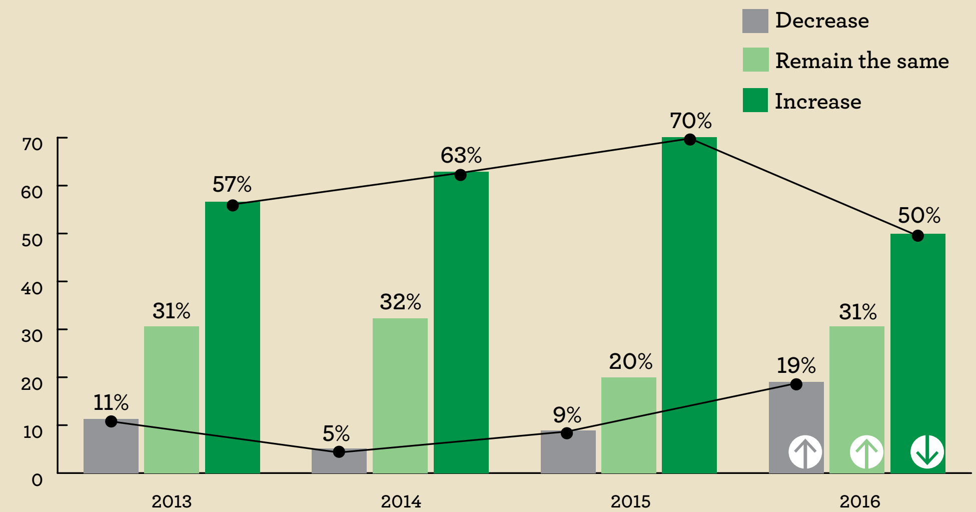
About half of contractors and distributors surveyed expect nonresidential activity to increase. Distributors increasingly expect activity to remain the same as the previous year.

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.

Photo courtesy of Arizona Materials LLC, Phoenix, AZ.

Distributors

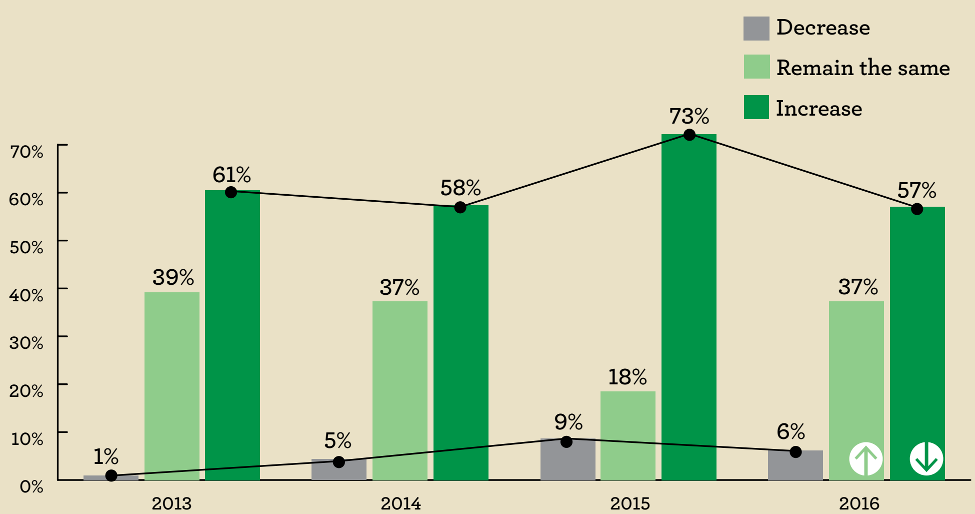
Do you think that your sales of new construction equipment this year compared to last year will:



The up and down arrows indicate a real (statistically significant) change from 2015.
Base: 132 equipment distributor and rental company respondents

Construction equipment distributors' expectations about year-over-year improvements in sales of new equipment peaked in 2015, with 70% expecting an increase. In 2016, fewer distributors believe sales of new construction equipment will increase, and more anticipate sales to remain on par with 2015. Nearly one-fifth of respondents said they expect new equipment sales to decrease compared to the previous year.

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

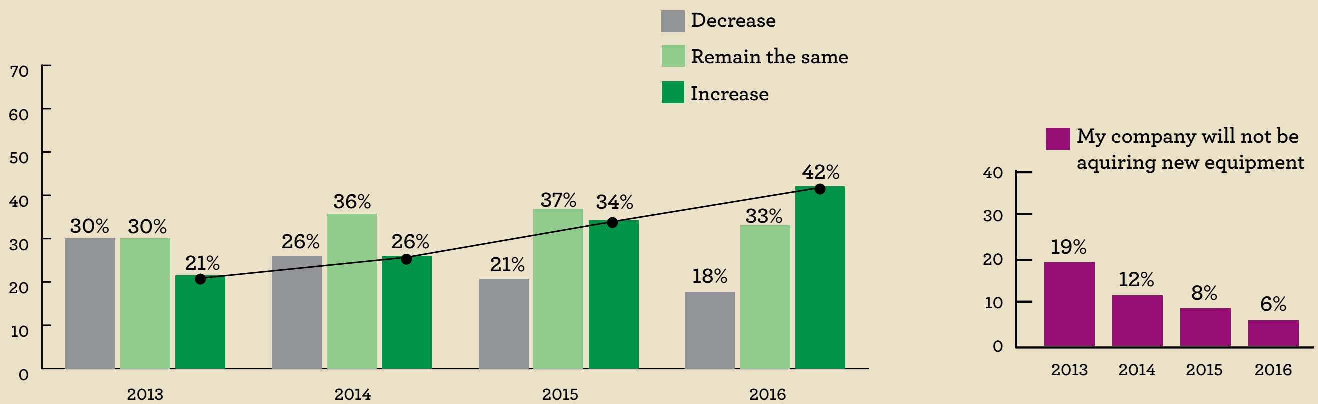


The up and down arrows indicate a real (statistically significant) change from 2015.
Base: 132 equipment distributor and rental company respondents

Following large expectations in 2015, distributor expectations for sales of used equipment have slowed. Distributor expectations are on par with 2013 and 2014, with 57% expecting an increase in sales and 37% expecting sales to remain flat.

Contractors

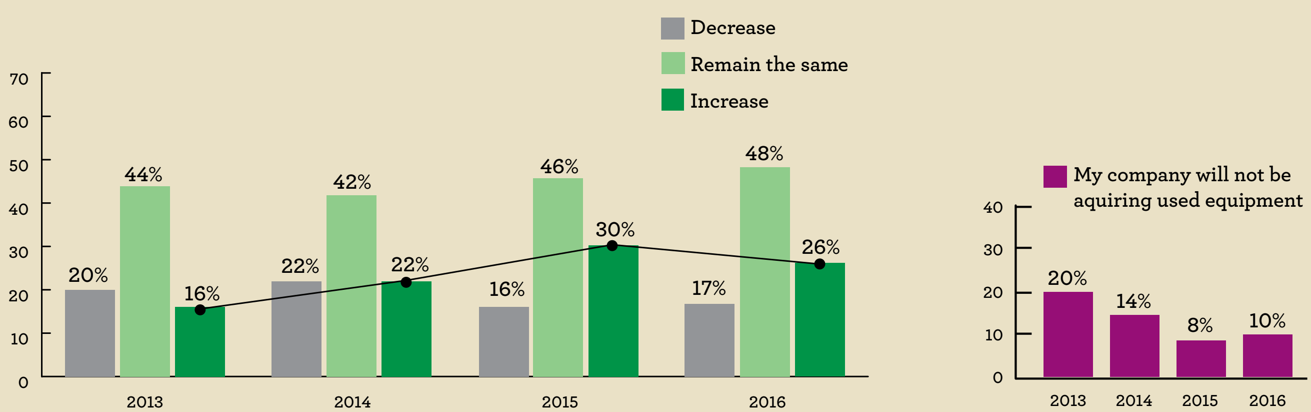
Do you think that your purchases of new construction equipment this year compared to last year will:



Base: 238 contractor respondents

Continuing on an upward trend, U.S. contractors expect to increase purchases of new construction equipment in 2016 compared to prior years. The portion of contractors expecting to increase their purchases of new equipment has doubled since 2013. As the percentage of contractors who say they will decrease new equipment purchases has steadily gone down over the years, we see a corresponding rise in the percentage who say they will increase new equipment purchases. Overall, 94% of contractors expect to acquire new equipment in 2016.

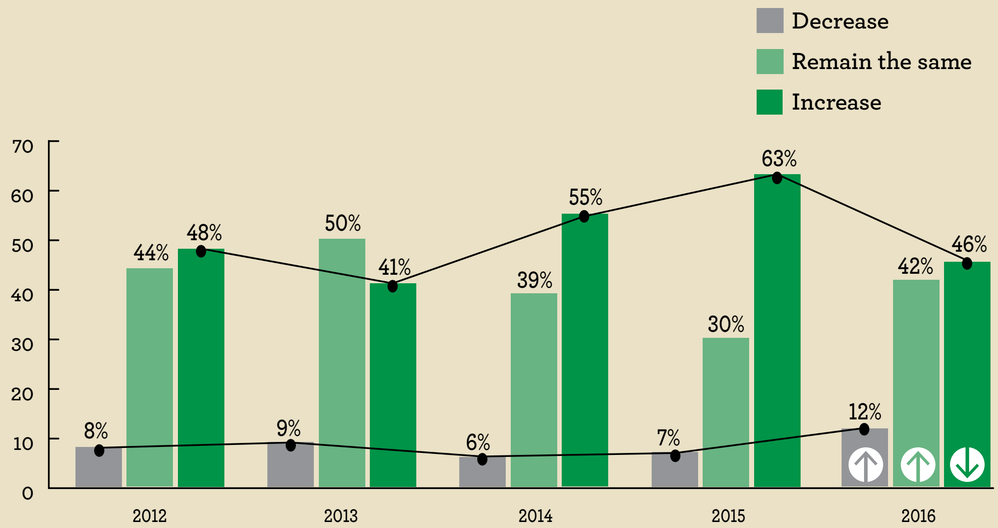
Do you think that your purchases of used construction equipment this year compared to last year will:



Base: 248 contractor respondents

Compared to new equipment, fewer contractors expect to purchase used equipment. Almost half of U.S. contractors (48%) said that purchases of used construction equipment in 2016 will be similar to purchases in 2015. The percentage of contractors who said they expect to increase used equipment purchases (26%) remained fairly consistent with 2015.

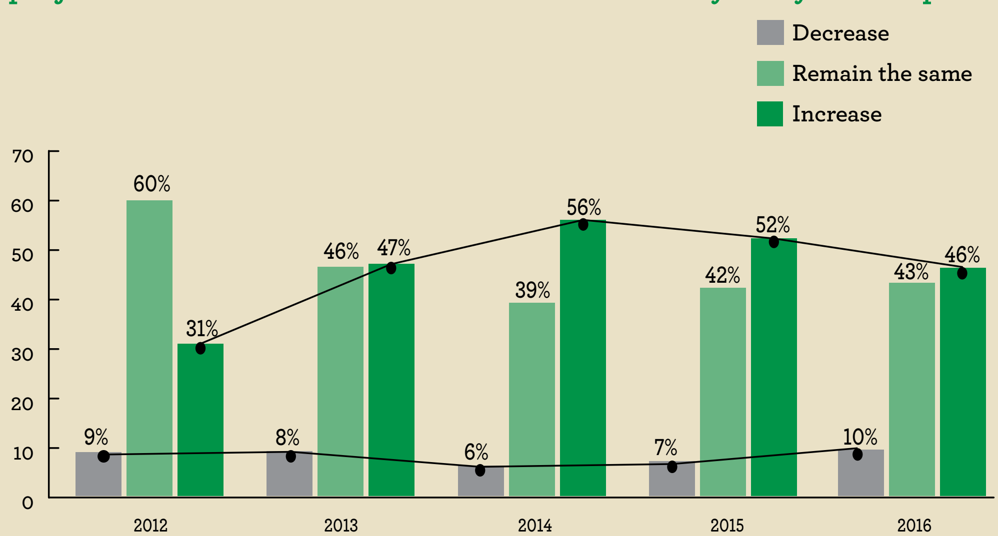
What is your projection for local **nonresidential construction** activity this year compared to last year?



The up and down arrows indicate a real (statistically significant) change from 2015.
Base: Total respondents

A majority of executives expect that local nonresidential construction activity will improve compared to the prior year, although fewer expected an increase than in 2015. The percentage of respondents who said activity would remain the same as last year increased from 30% in 2015 up to 42% in 2016. Meanwhile, 46% said that activity levels would increase, which is less than the 63% that expected activity levels to increase in 2015. The percentage of industry executives who predicted that local nonresidential activity would decline in 2016 increased to 12%, up from 7% in the year prior.

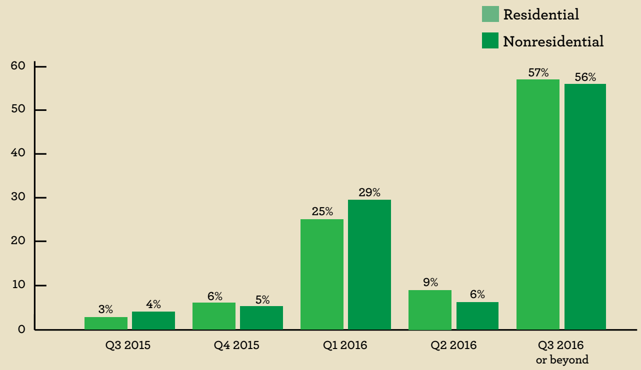
What is your projection for local **residential construction** activity this year compared to last year?



Base: Total respondents

The sentiment toward residential construction activity in 2016 remains positive among executives surveyed, but declined slightly compared to 2015. Nevertheless, the overall trend indicates that residential construction activity will remain fairly steady, with 43% responding as such. The sentiment looks very similar to respondents in 2013. Only 10% said they expect activity to decline in 2016, which is again remarkably similar to the sentiment in 2013.

When do you expect local nonresidential and residential construction activity to begin improving?



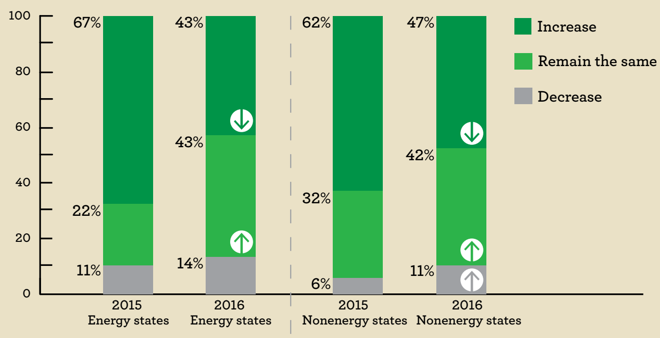
Base: Respondents who said local construction activity would decrease or remain the same in 2016 compared to 2015

Of the executives who said they expect similar or less residential activity in 2016 compared to 2015, close to half (43%) expect to see at least some improvement before the end of 2016. However, a little more than half of these executives (57%) said that an improvement in residential construction wouldn't come until the 4th quarter of 2016 or later.

Of the executives who said they expect similar or less nonresidential activity in 2016 compared to 2015, less than half (44%) said they expect to see at least some improvement before the end of 2016. More than half (56%) said that an improvement in nonresidential construction wouldn't come until the fourth quarter of 2016 or later.

How do expectations of increases in construction activity differ from respondents in Energy states (defined as states with Oil and Gas industries)? For purposes of this survey, we identified North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Texas, and Wyoming as Energy states.

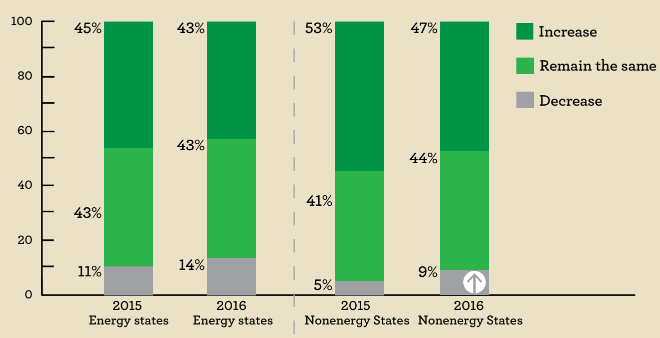
What is your projection for local nonresidential construction activity this year compared to last year?



The up and down arrows indicate a real (statistically significant) change from 2015.
Base: Total respondents. Energy states (Oil and Gas) include North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Texas, and Wyoming; All other states are Nonenergy states.

Generally, executives from Energy states (Oil and Gas) do not feel differently than those from all others. Both groups of respondents increasingly believe that activity in the **nonresidential** construction market will remain consistent with 2015. Just under half of the respondents from both groups believe there will be an increase in activity, fewer than in 2015. In both groups, an increasing number expect that activity will stay the same.

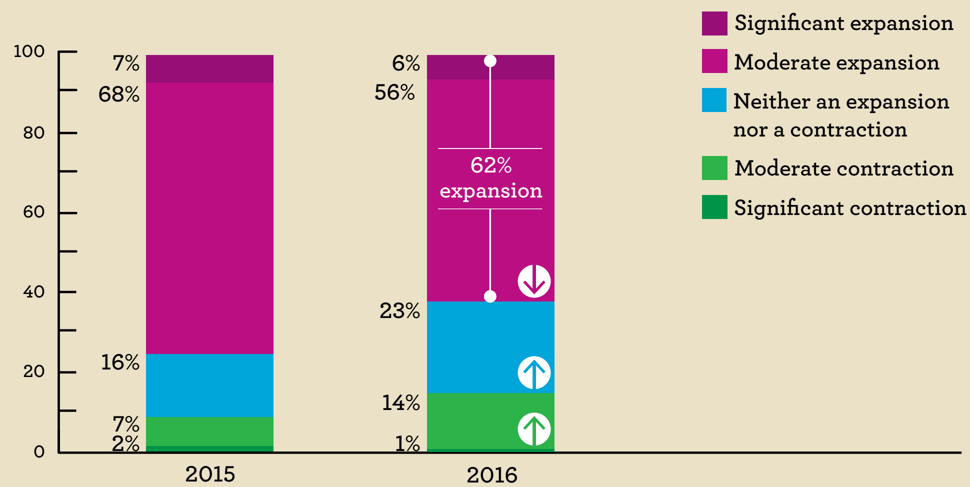
What is your projection for local residential construction activity this year compared to last year?



The up and down arrows indicate a real (statistically significant) change from 2015.
Base: Total respondents. Energy states include North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Texas, and Wyoming; All other states are Nonenergy states.

Optimism for an increase in **residential construction** activity is also consistent between states defined as Energy states (Oil and Gas) and all others. About half of all respondents feel activity will increase and just less than one-half of all respondents feel activity in residential construction will remain about the same as in 2015.

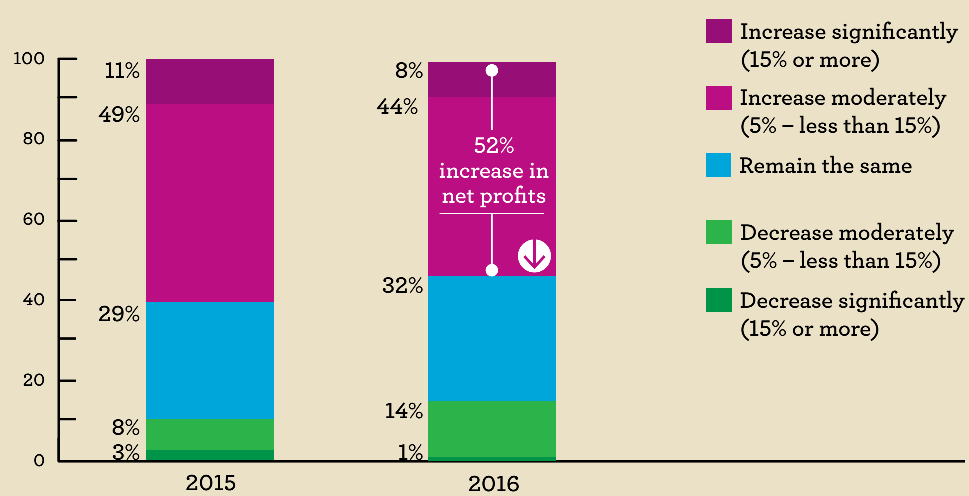
Two years from now, which of the following scenarios is most likely to occur?



The up and down arrows indicate a real (statistically significant) change from 2015.
Base: Total respondents

The two-year outlook among construction industry executives paints a cautiously steady picture. More than half of respondents (56%) said that a "moderate expansion of the U.S. construction industry" would likely occur within the next two years. Another 23% were confident the construction industry would maintain a mostly flat growth trajectory for the next two years. Another 15% expect to see a moderate (14%) or significant (1%) contraction in the U.S. construction industry.

Compared to net profit for 2015, do you think your net profit for 2016 will:



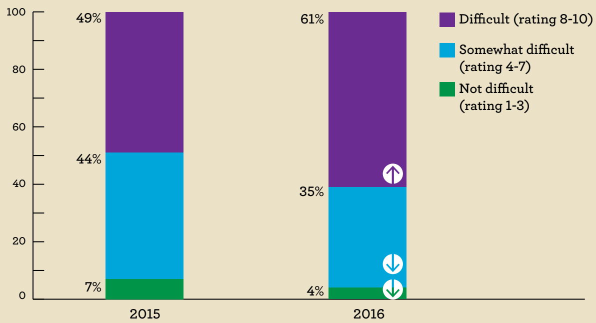
The up and down arrows indicate a real (statistically significant) change from 2015.
Base: Total respondents

Industry leaders expect their businesses will continue to grow in profitability in the year ahead, although they are slightly less optimistic than in 2015. More than half (52%) said that their net profit in 2016 will increase moderately (44%) or significantly (8%), compared to only 1% who said they expect a significant decrease in net profit.

Hiring practices

Industry executives we speak to consistently indicate that it can be difficult to find and retain qualified workers. With wages and health insurance among the top cost concerns of industry executives surveyed, Wells Fargo Equipment Finance attempted to quantify the sentiment about the labor market and the degree to which qualified workers are difficult to find.

How difficult is it to find qualified workers to fill your open positions? Please rate on a scale of 1 to 10 with 10 being most difficult.



The up and down arrows indicate a real (statistically significant) change from 2015.
Base: Total respondents

More than half (61%) of executives said that it is very difficult to find qualified workers, rating difficulty as 8, 9, or 10 on a 10-point scale. Only 4% experience little difficulty finding workers.

What strategies and resources are most effective in finding qualified workers? Please rank the top three.

Strategies and resources	2015	2016	
Referrals from current employees	57%	52%	
Jobs and networking websites	8%	15%	↑
Apprenticeship programs	7%	9%	
Trade schools	8%	8%	
Company website	7%	5%	
Staffing agency	5%	4%	
Career fairs	2%	1%	
Other	5%	7%	

The up and down arrows indicate a real (statistically significant) change from 2015.
Base: Total respondents

More than half of the survey respondents (52%) said their most widely used strategy to find qualified workers was "referrals from current employees." This strategy was followed by "jobs and networking websites," with 15% using this resource — significantly more than the 8% in 2015.

What benefits are most effective at retaining employees?

Response	2015	2016
Compensation and bonus structure	46%	48%
Overall company culture	34%	29%
Health insurance	15%	17%
Sick days/Paid time off/Holidays	2%	3%
401k with matching contributions	1%	2%
Company car	1%	1%
Other	1%	*

* Total responses amounted to less than 1%.
Base: Total respondents

Compensation and bonus structure continues to be the most effective benefit to retain employees, with 48% ranking it at the top in retention benefits. Company culture is also critical, with 29% ranking it as the top benefit effective in retaining employees.

Construction Industry Overview

Anika Khan, Senior Economist
Wells Fargo Securities, LLC

Anika R. Khan is a director and senior economist with Wells Fargo with more than 15 years of experience in Corporate and Investment Banking including U.S. macroeconomic and quantitative analysis, institutional sales and trading analytics and commercial mortgage-backed securities underwriting. Based in Charlotte, North Carolina, she is responsible for producing commentary on U.S. residential and nonresidential real estate and construction markets.

The U.S. economy is poised to enter 2016 on solid footing. Recent economic activity and labor market conditions in the U.S. show that downside risks to the outlook for the economy have largely faded. Economic growth has settled into a 2% – 2.5% range and is projected to continue to advance around the same rate during the next two years. Nonfarm employment is expected to average 188,000 jobs per month in the year ahead, which is a slightly slower pace than in 2015. While the net number of jobs created is likely to be slightly less than in 2015, the quality of jobs should be better, with more full-time positions. Compensation is also likely to accelerate. We expect nominal personal income to grow 5.1% in 2016, up slightly from 4.6% in 2015. The improvement in employment and earnings will continue to support consumer confidence and household formation, both of which have risen back to levels that, in the past, have supported healthy gains in home sales and spending on big-ticket items. (Figure 1)

Consumer spending remains the largest contributor to economic growth and has picked up in the past two years. The fundamentals of consumer spending — job growth, wage and salary growth, household wealth, consumer confidence, and credit availability — all have improved. Although we expect consumer spending to remain strong in 2016, we are looking for a fairly conservative 2.8% rise in personal consumption expenditures, which is slightly less than the 3.1% gain posted this past year. One of the reasons for our caution is that motor vehicle sales, which ended the year around an 18-million-unit pace, appear to be a bit extended. Sales have been helped along by easier credit than in previous cycles, which means auto sales may be close to topping out. (Figure 2)

For those sectors of the outlook tied primarily to the domestic economy, 2016 is likely to see better results, at least relative to economic expansion. For components closely tied to the global economy, the economic environment will be more challenging.

Figure 1

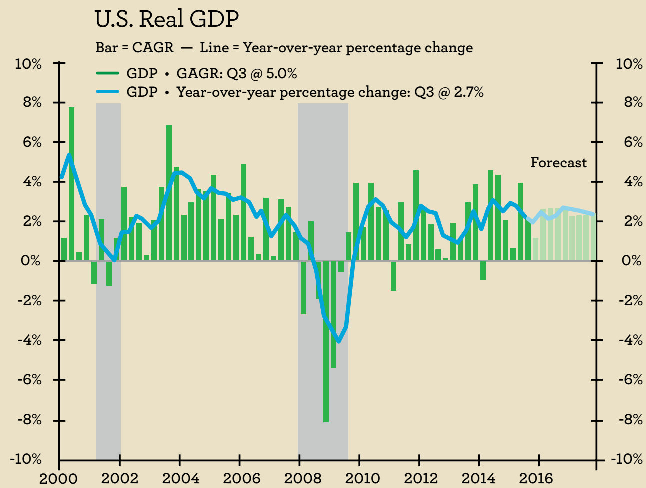
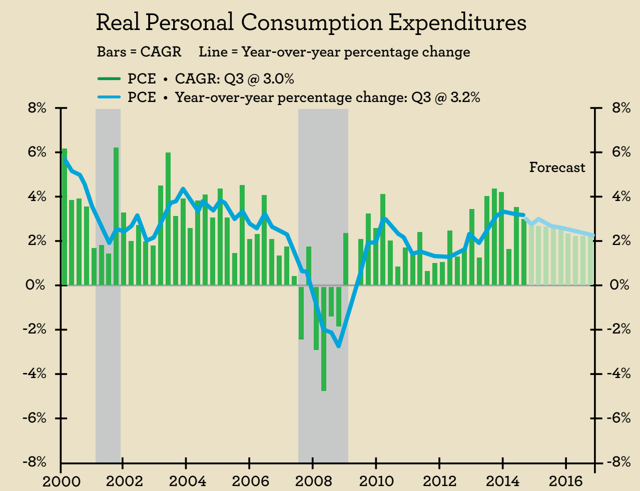


Figure 2



Source: U.S. Department of Commerce and Wells Fargo Securities, LLC.

Photo courtesy of Aldridge Electric, Inc., Libertyville, IL.

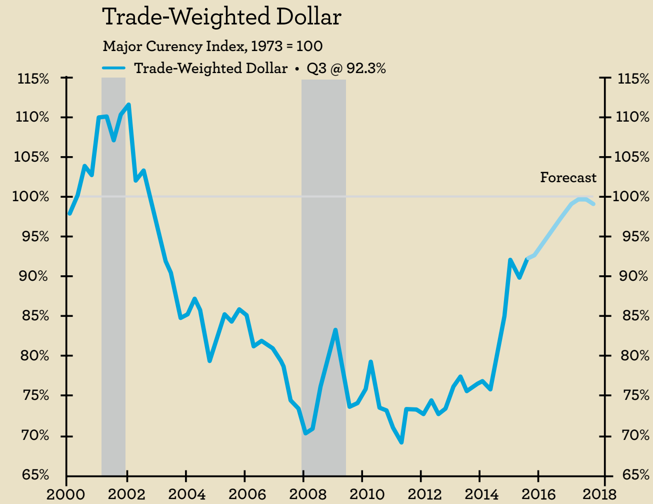
Activities related to oil and gas exploration should continue to contract in 2016, although at a much slower pace than in 2015. The consensus on energy prices has changed a great deal during the past year. Hopes that U.S. production would quickly decline and allow prices to rebound have faded away, and the new mantra is that oil prices are likely to stay low for longer. The International Energy Agency (IEA) recently noted that it does not expect oil prices to rebound back above $80 per barrel before 2020. We agree with this projection. Oil prices are unlikely to increase until we have seen a meaningful consolidation among U.S. energy producers, particularly among the "new" energy producers, and a significant improvement in global economic growth.

Investment tied to the energy boom continues to unwind. Orders for steel pipes, which are used for drilling; railcars used to haul fracking materials, sand and oil; and heavy industrial equipment used to prepare and operate drilling sites have all declined considerably in the past year. Demand for trucks, oil field equipment, and mining machinery has also fallen. Slower global economic growth and the stronger dollar are also taking a toll on investment spending. Businesses are understandably reluctant to expand production capacity during a time when demand remains weak relative to prior expectations and profit margins are being squeezed. The farm sector is also getting squeezed by lower commodity prices, and therefore purchases of farm equipment have tumbled. We are looking for business fixed investment in equipment to rise 4.8% in 2016, following a 3.4% rise in 2015.

Slower global economic growth means that international trade will likely continue to be a drag on U.S. gross domestic product (GDP) growth in 2016. We expect imports to rise 4.6% in 2016, following a 5.1% rise in 2015. The increase reflects solid consumer demand and the stronger dollar, which make imported goods less expensive for U.S. purchasers. We are looking for the major currencies' trade-weighted dollar to rise roughly 5% in 2016. A stronger dollar will make it even more difficult for U.S. exporters to compete against producers overseas. Moreover, several nations including Russia, Brazil, Turkey, and Mexico, have seen their currencies weaken much more relative to the U.S. dollar, adding more competition for U.S. exporters in markets abroad. (Figure 3)

Against this backdrop, private nonresidential construction spending is on track to finish the year up more than 10% relative to a year earlier, and should continue to advance in 2016. Much of the improvement has been due to outsized gains in the manufacturing, hotel, office, and amusement and recreation sectors. Early indicators, including billings and planning, suggest these sectors will continue to see strong growth in the coming year, but the pace will likely moderate. Although the mining sector was hard hit due to the drop in oil prices, chemical manufacturers benefitted from the drop in natural gas prices and increased plant construction at a healthy clip. It is estimated that more than 100 chemical plants have been built

Figure 3



Source: Federal Reserve Board and Wells Fargo Securities, LLC.

Photo courtesy of Ozinga Ready Mix Concrete, Inc., Mokena, IL.

in the past three years. Much of the plant construction is taking place in Louisiana and Texas.

Outlays in the lodging sector have outperformed in recent years, rising more than 20% in 2014 and nearly double that pace in 2015. According to Smith Travel Research, the occupancy rate remains elevated, the average daily rate (ADR) continued to advance, and revenue per available room (RevPAR) was up 6.7% in the past year. Much of the increase in RevPAR is being driven by solid gains in ADR. The biggest risk in the hotel sector is the slower pace of global business travel and U.S. international visitation, especially in gateway markets. The pace of overseas visits has slowed, rising just 1.8% in April relative to a year earlier. In 2014, visitation was up 6.7%. (Figure 4)

On a regional basis, weakening office fundamentals in Houston are raising concern. The pace of office-using employment in Houston fell to just 0.1% in the past year, while growth in the nation rose to 2.9% in October. At the same time, supply is far outpacing demand, which pushed the vacancy rate up in Houston to 15.7% in the third quarter. Unfortunately, the worst is likely not behind us. Deliveries are expected to spike in the coming years. Oklahoma City is another market that we are closely monitoring for weak performance in the office market.

Following two years of declines, institutional building rebounded in 2015. Private healthcare construction spending is getting a significant boost from investment in hospital construction projects and is up 15.2% from 2015. Much of the increase, however, has been in renovations and expansions. Construction spending for medical buildings has been weak since mid-2014, and the improvement in special care construction spending is slowing. Theme park construction is booming and is up 52.1% year over year. Despite these gains, forward-looking indicators suggest institutional outlays will improve at a slower pace in 2016. (Figure 5)

That said, structure investment, which feeds into the real GDP calculation, is expected to detract from economic activity in 2015 due to weakness in the mining, exploration, shaft, and wells component. Mining, which now makes up 16.5% of overall private construction outlays, continues to shave off a sizable amount from overall real construction outlays. Manufacturing construction is expected to continue to show outsized gains in 2016, still on the back of the chemical sector; however, the pace of growth is expected to moderate. Healthcare, office, lodging, and theme park construction spending are also expected to continue to strengthen. (Figure 6)

Labor market conditions in nonresidential construction continued to improve during the year. However, one of the biggest worries in the sector is the high level of unfilled construction jobs as workers displaced during the downturn found work in other sectors. Wage and salary growth in the construction sector remained unchanged during the quarter but continues to outpace the nation. We expect as labor market conditions continue to firm, wage and salary growth should

Figure 4

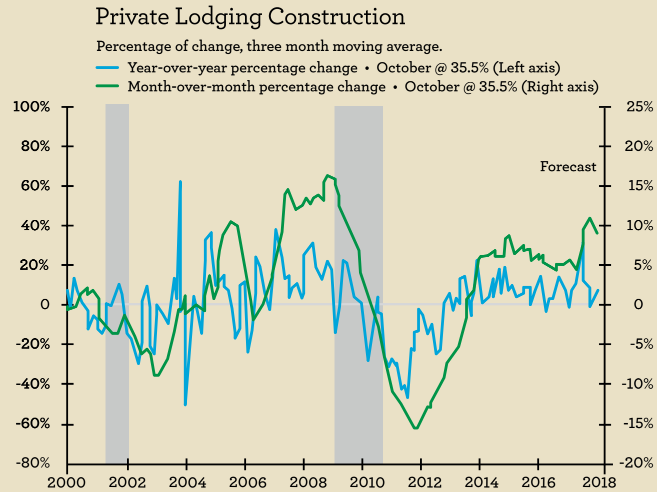


Figure 5

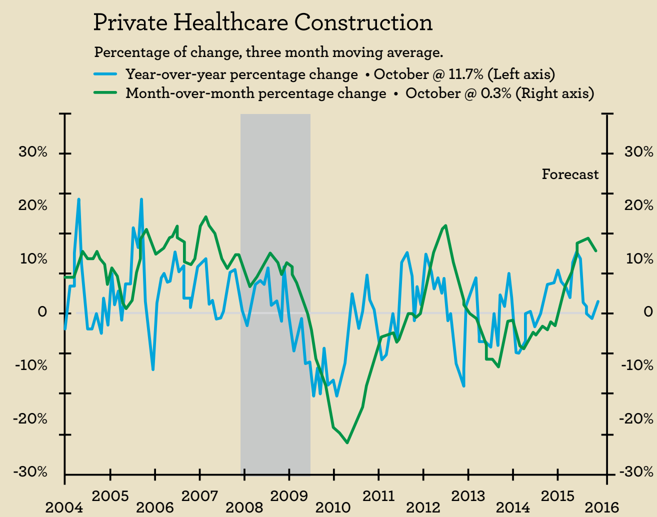
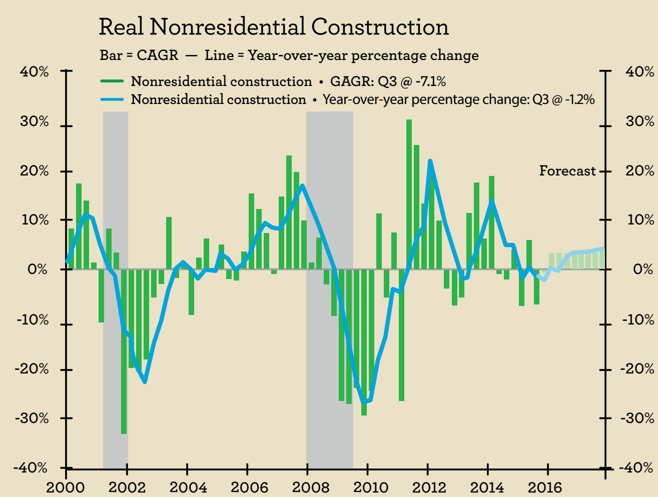


Figure 6



Source: U.S. Department of Commerce and Wells Fargo Securities, LLC.

trek higher. Conversely, the sharp drop in oil prices continues to keep prices in the construction sector at a low level. Prices for softwood lumber, gypsum, and concrete, to name a few, remain low. However, in typical fashion, producers are already announcing price increases that will take place in the beginning of the year to see if gains will stick.

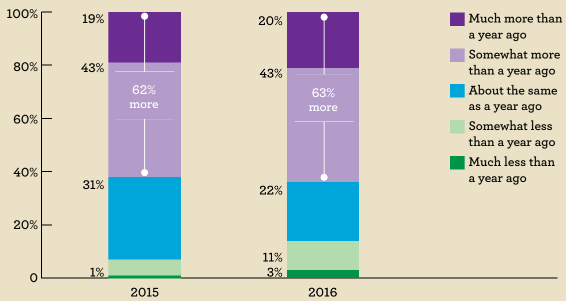
Our forecast for private nonresidential construction put-in-place remains largely unchanged. We expect nonresidential outlays to increase 11.7% in 2015 and advance between 7% – 9% in 2016. However, with institutional and manufacturing construction set to moderate in 2016, the overall pace will likely slow in the coming year.

Photo courtesy of Rummel Construction, Inc., Scottsdale, AZ.

Rental review

Survey respondents indicated that they expect the equipment rental market to remain consistent in 2016 and continue to grow. They also said that the biggest risks to the growth of the industry are economic and political uncertainty. Without the stability of knowing that there will be consistent funding for work, it's not surprising that the equipment rental industry has grown significantly in the past few years and that it continues to forecast growth for 2016.

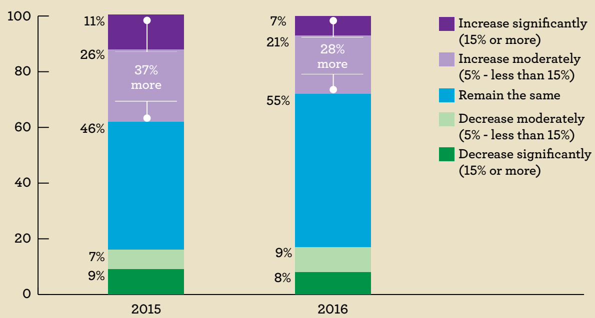
(Distributors) Compared to a year ago, how much construction equipment are you now **renting** out to contractors?



Base: Total distributor and rental company respondents

Equipment distributors and rental companies continue to see growth in the rental market. Nearly two-thirds of distributors reported they are renting more equipment to contractors than a year ago. These findings are consistent with 2015.

(Contractors) Do you think that your rental of heavy construction equipment in 2016, compared to 2015, will:



Base: Contractors that rented heavy construction equipment

Most contractors (55%) believe that their equipment rental will remain strong, at a similar level to 2015. Nearly one-third (28%), expect to increase heavy construction equipment rentals this year, which is down from 37% last year in 2015.

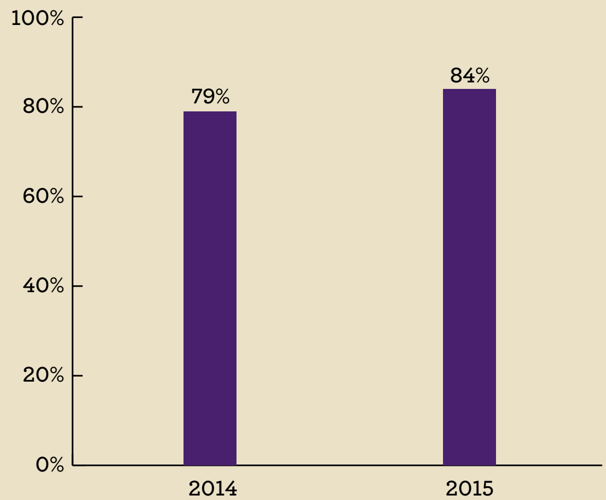
(Contractors) Why do you rent construction equipment? Please rank the top three.

	Top reason % (Ranked 1st)	2015	2016
Flexibility needed	Need for project-specific equipment	32%	40%
	Lack of consistent work to justify equipment acquisition	27%	29%
	Flexibility to return equipment at the end of the term	15%	17%
	Overall cost of equipment	7%	4%
	Renting is more economical than buying	4%	3%
	Local economic conditions	2%	2%
	Transfer the risk of ownership to dealer	3%	1%
	Bonding company considerations	2%	*
	National economic conditions	1%	*
	Regulatory/political conditions	1%	0%
	Risk of equipment becoming obsolete	1%	0%
	Other	6%	3%

Base: Total contractor respondents

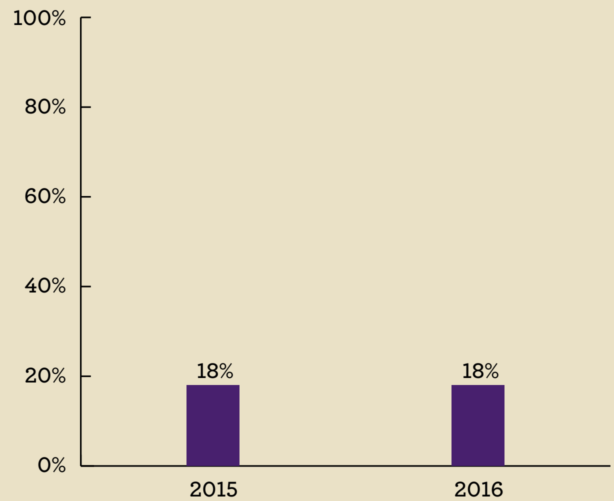
Respondents cited the need for project-specific equipment most frequently (40%) as the most important factor in renting equipment instead of buying. As in 2015, lack of consistent work (29%) and the need to have flexibility to return the equipment at the end of the term when it's no longer needed (17%) rounded out the top three reasons contractors rent instead of buy. Needing flexibility drives the demand for rentals.

(Contractors) Did your company rent any heavy construction equipment in 2015? (% = yes)



Base: Total respondents

(Contractors) Do you think that you will rent heavy construction equipment in 2016? (% = yes)



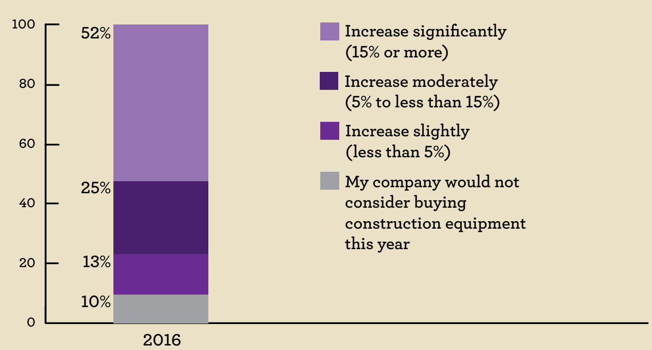
Rental of heavy construction equipment remained strong in 2015, with 84% of contractors saying they rented heavy equipment. On par with previous years, only about one-fifth of those who did not rent heavy construction equipment this year, anticipate renting equipment in 2016. What would it take to consider buying equipment instead of renting? Contractors want to see a strong backlog of jobs and long-term confidence in the local and national economy before buying equipment. Lower equipment costs are less likely to prompt buying than other factors. Rental costs would need to increase by 15% or more for most executives to considering purchasing instead of renting equipment.

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

Most important factors	2015	2016
Stronger backlog of jobs	29%	25%
Long term confidence in the local economy	24%	19%
Long term confidence in the national economy	15%	14%
Return of Bonus Depreciation	9%	12%
Passing of a long-term highway funding bill	7%	10%
Lower equipment costs	7%	7%
Special low rate interest programs	6%	6%
My company would not consider buying construction equipment in 2016	0%	2% ↑
Other	3%	4%

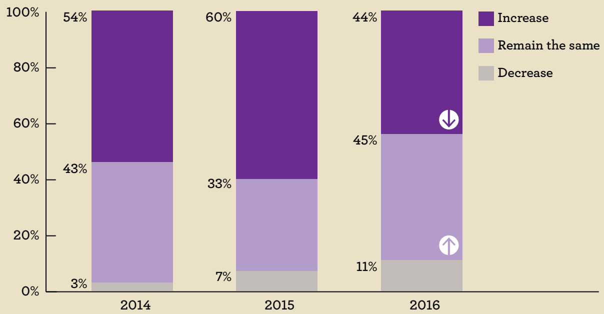
The up and down arrows indicate a real (statistically significant) change from 2015.
Base: Total contractor respondents

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



Base: Total contractor respondents whose companies would consider buying equipment in 2016

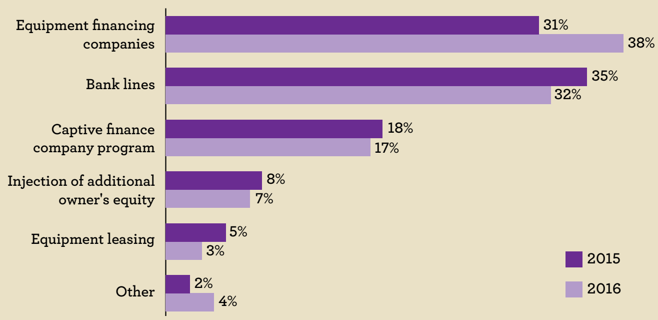
(Distributors) Do you think that the size of your rental fleet this year compared to last year will:



The up and down arrows indicate a real (statistically significant) change from 2015.
Base: Total distributor and rental company respondents

Nearly half (45%) of distributors expect their fleet size will remain the same as in 2015. Although down from the previous year, 44% still expect the size of their rental fleet to increase. Eleven percent expect their rental fleet to decrease, compared to 7% in the prior year.

(Distributors that will increase rental fleet) Of the following, which is the top way you **intend to fund** the increase in your rental fleet?

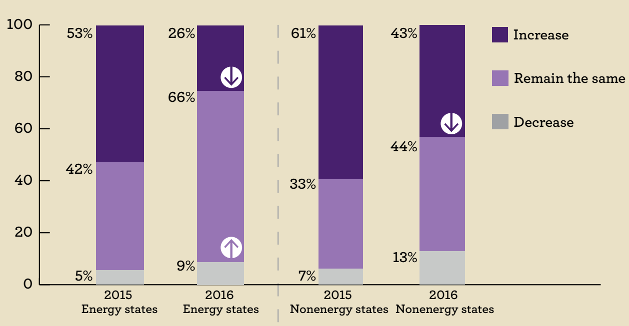


Base: Total distributor and rental company respondents

More than one-third (38%) of respondents said they would use equipment financing companies to fund the increase in their rental fleet, up significantly from 2015 and taking the #1 spot. Thirty-two percent of respondents said they would turn to a bank relationship for capital.

How do expectations concerning projected 2016 rental fleet sizes compare for distributor respondents from Energy states (Oil and Gas)? For purposes of this survey, we define North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Texas, and Wyoming as Energy states. Executive respondents from Energy states with Oil and Gas industries are more likely to think that the size of their rental fleet will remain the same as in 2015. Although sample sizes are limited, a smaller portion (26%) in the Energy states expect to see an increase in rental fleet sizes, compared to 53% in 2015. This is on track with respondents from Nonenergy states, who also expect a decline in rental fleet increases. Higher percentages from both Energy and Nonenergy states are expecting rental fleet sizes to stay the same as the previous year.

(Distributors) Do you think that the size of your rental fleet this year compared to last year will:



The up and down arrows indicate a real (statistically significant) change from 2015.
Base: Total respondents. Energy states (Oil and Gas) include North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Texas, Wyoming; all other states are Nonenergy states.

Risk, regulation, and opportunity

Which of these factors poses the greatest **risk** to the U.S. construction industry in 2016? Top answer % (ranked 1st).

Answer option	2015	2016	
National economic uncertainty	25%	33%	↑
Political/regulatory uncertainty	30%	29%	
Local economic uncertainty	8%	9%	
Rising interest rates	8%	9%	
Falling oil prices	14%	8%	↓
The nonresidential construction market	2%	4%	
Rising material costs	3%	3%	
The residential construction market	4%	3%	
Tier IV emission standards	5%	1%	↓
Other	1%	1%	

The up and down arrows indicate a real (statistically significant) change from 2015.
Base: Total respondents

National economic uncertainty (33%) and political and regulatory uncertainty (29%) continue to be top factors that executives believe are the greatest risks to the construction industry.

Which of these factors creates the greatest **opportunity** for growth in the U.S. construction industry in 2016? Top answer % (ranked 1st).

Answer option (Ranked 1st)	2015	2016	
Improving national economic situation	23%	23%	
Increased consumer confidence	17%	16%	
Increased government spending	8%	14%	↑
Improving political climate	11%	12%	
Improving local economic situation	10%	10%	
Stable regulatory environment	9%	7%	
The residential construction market	9%	7%	
The nonresidential construction market	8%	7%	
Public/private partnerships (PPP)	3%	2%	
Other	2%	*	

The up and down arrows indicate a real (statistically significant) change from 2015.
*Total responses amount to less than 1%. Base: Total respondents

As in 2015, executives believe that improving the national economic situation would create the greatest opportunity for growth in the industry (23%).
Respondents also believe increasing government spending (14%) would create significant construction industry growth opportunities.

Which of the following regulatory issues is of greatest interest to you as it relates to your company? Top answer % (ranked 1st).

Top answer % (Ranked 1st)	2015	2016
Highway Funding Bill	32%	37%
Tax incentives such as bonus depreciation and section 179	31%	33%
Affordable Care Act	14%	12%
Debt ceiling	4%	5%
Tier IV emission standards	9%	5%
Gas tax	4%	4%
Hours of service (HOS)	4%	3%
Other	2%	2%

Base: Total respondents

Consistent with 2015, the regulatory issues of greatest interest for 2016 are the Highway Funding Bill (37%), followed by Tax Incentives (33%). The Affordable Care Act is a secondary priority with 12% claiming it is of top interest.

Business strategy — contractors vs. distributors

Cost concerns are very similar among contractors and distributors. As in 2015, at the time of the 2016 survey, fuel prices were falling, so respondents did not list fuel as a top concern. Employee wages and other benefits (30%) and healthcare costs (22%) ranked as contractors' top cost concerns, while equipment costs (24%) and healthcare costs (21%) were distributors' top cost concerns.

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

Type	2015	2016
Employee wages and other benefits	31%	30%
Healthcare costs**	21%	22%
Taxes	19%	19%
Equipment purchase costs	12%	10%
Material costs	7%	8%
Fuel costs	6%	6%
Financing costs	1%	3%
Equipment rental costs	2%	1%
Other	*	2%

* Total responses amount to less than 1%
** 58% of those surveyed have 51 or more employees, implying they have health insurance for employees.
Base: Total contractor respondents

The top concerns among contractors continue to be employee wages and other benefits, healthcare costs, and taxes. It's notable that 58% of survey respondents have more than 51 employees, therefore implying they offer health insurance for employees.

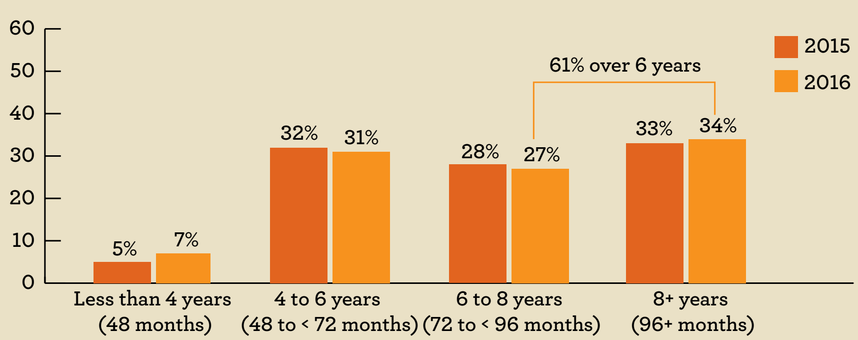
(Distributors) Of the following cost categories, which three concern you the most? Please rank the top three.

Type	2015	2016
Equipment costs	29%	24%
Healthcare costs	28%	21%
Equipment rental costs — cost of carrying rental fleet	15%	21%
Employee wages and other benefits	9%	17% ↑
Taxes	12%	10%
Financing costs	7%	7%

The up and down arrows indicate a real (statistically significant) change from 2015.
Base: Total distributor and rental company respondents

Distributors continue to be most concerned about equipment costs and healthcare costs. However, the concern over employee wages and other benefits rose sharply this year to 17%, possibly a result of increasing demand for workers.

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

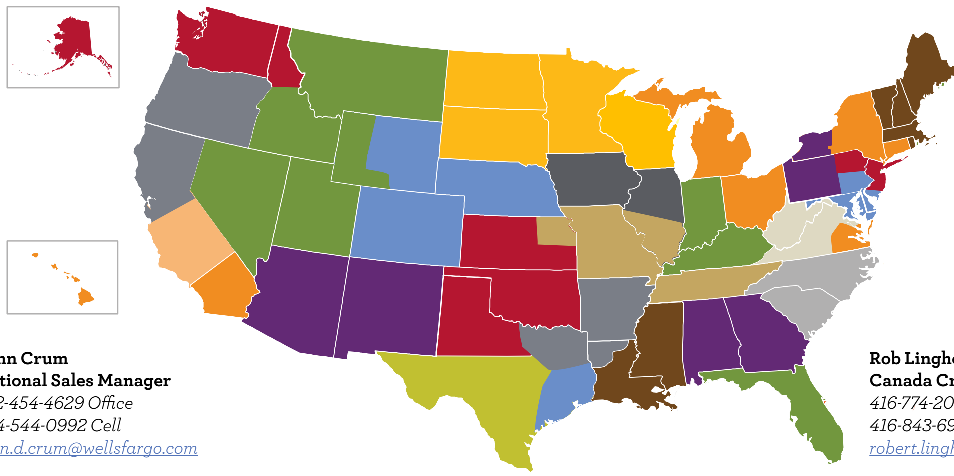


Base: Total contractor respondents

Nearly two-thirds (61%) of contractor respondents own their equipment for more than 6 years. Most respondents prefer to keep heavy construction equipment for the long term.

Find a Construction Equipment Finance Specialist near you

The coverage map below shows the network of construction industry specialists who focus solely on helping companies with construction equipment needs to find the financing that suits them best.



John Crum
National Sales Manager
412-454-4629 Office
724-544-0992 Cell
john.d.crum@wellsfargo.com

Rob Linghorne
Canada Cross-Border Sales
416-774-2025 Office
416-843-6996 Cell
robert.linghorne@wellsfargo.com

U.S. Western region
Kay Russell, Sales Manager
602-432-7240
lyman.k.russell@wellsfargo.com

Washington, Alaska, Northern Idaho
CJ Markey
206-849-7937 | 866-359-0749 Fax
clyde.j.markey@wellsfargo.com

Oregon, Northern California
Ryan Murphy
503-887-5986 | 866-359-0757 Fax
ryan.e.murphy@wellsfargo.com

Central California
Tom White
925-350-1787
thomas.r.white@wellsfargo.com

Southern California, Hawaii
Ralph Potter
619-540-2296 | 866-359-0761 Fax
ralph.e.potter@wellsfargo.com

Montana, Western Wyoming, Utah, Nevada, Southern Idaho
Steve Pratt
801-541-8699 | 866-359-0762 Fax
steven.l.pratt@wellsfargo.com

Arizona, New Mexico
Dana Pike
602-432-7234 | 866-359-0760 Fax
dana.r.pike@wellsfargo.com

Dallas, Northeastern Texas, Arkansas, Northwest Louisiana
Frank Gullo
972-342-3594 | 866-359-0745 Fax
frank.j.gullo@wellsfargo.com

San Antonio, Southern and Western Texas
Jim Shewmaker
210-240-6774 | 866-359-0771 Fax
james.b.shewmaker@wellsfargo.com

Houston, Gulf Coast Texas
Nick Webb
713-882-7727 | 866-359-1033 Fax
nicholas.b.webb@wellsfargo.com

Large Ticket BDO – West Coast
Scott Cleland
949-251-4108
scott.cleland@wellsfargo.com

U.S. Central region
Steve Nenn, Sales Manager
312-316-9139
steven.s.nenn@wellsfargo.com

Northern Texas, Oklahoma, Kansas (except Kansas City)
Patrick Miller
214-914-1378 | 866-347-5217 Fax
patrick.l.miller@wellsfargo.com

Tennessee, Southern Illinois, Missouri, and Greater Kansas City
Mike Range
618-606-1661 | 866-968-8713 Fax
michael.s.range@wellsfargo.com

Northern Illinois, Iowa
Tom Zubik
312-550-4789 | 866-512-9732 Fax
thomas.l.zubik@wellsfargo.com

Louisiana, Mississippi
Cal Shoemake
985-807-3988 | 866-493-1774 Fax
calvin.shoemake@wellsfargo.com

Indiana, Kentucky
Fred Sugg
317-435-0504 | 866-359-0776 Fax
frederick.c.sugg@wellsfargo.com

Ohio, Michigan
Kevin Watkins
440-787-7600 | 877-402-2261 Fax
kevin.c.watkins@wellsfargo.com

Colorado, Nebraska, Eastern Wyoming
Chris Benitez
719-591-7239 | 866-512-6974 Fax
christopher.b.benitez@wellsfargo.com

Minnesota, North Dakota, South Dakota, Wisconsin
Mark Jangula
612-803-3369 | 866-739-3180 Fax
mark.j.jangula@wellsfargo.com

Large Ticket BDO – Central Region
Peter Gregory
770-551-4638 | 877-771-7314 Fax
peter.d.gregory@wellsfargo.com

U.S. Eastern region
Tom Reilly, Sales Manager
201-452-7479
thomas.r.reilly@wellsfargo.com

Maine, New Hampshire, Vermont, Rhode Island, Massachusetts
Open
201-452-7479 | 866-359-0765 Fax
thomas.r.reilly@wellsfargo.com

New York Metro; Upstate New York; Connecticut; Richmond, Virginia
Amy Majeskie
201-446-6835 | 877-401-7239 Fax
amy.majeskie@wellsfargo.com

Central/Northern New Jersey, Northeastern Pennsylvania
Todd Yazujian
732-319-4576 | 866-359-1035 Fax
todd.d.yazujian@wellsfargo.com

Southern NJ, Southeastern Pennsylvania, Delaware, Maryland (except panhandle)
Tom Kassakatis
215-779-2981 | 866-493-4485 Fax
thomas.g.kassakatis@wellsfargo.com

Western Pennsylvania, Western New York
Gil Clements
412-721-0427 | 866-361-7667 Fax
gilbert.a.clements@wellsfargo.com

West Virginia, Maryland Panhandle, Virginia (except Richmond)
Doug Snee
724-998-5941 | 866-359-0774 Fax
douglas.e.snee@wellsfargo.com

South Carolina, North Carolina
Jack Kirk
803-463-9001 | 866-359-0750 Fax
jack.r.kirk@wellsfargo.com

Alabama, Georgia
Patricia Hollis
470-208-9549 | 866-648-7030 Fax
patricia.hollis@wellsfargo.com

Florida
Open
201-452-7479 | 866-359-0765 Fax
thomas.r.reilly@wellsfargo.com

Large Ticket BDO – East Coast
Kevin Kresinski
412-337-0892
kevin.kresinski@wellsfargo.com