crédito y caución
Atradius Group

market monitor

Focus on construction sector performance and outlook

March 2014

Count the cranes

They say that you can gauge the health of a country's economy by the number of cranes operating across its city skylines, and that certainly seems to hold true as we focus on the construction industry across some key markets. There are some stark contrasts too: between the industries' performance in the different countries featured in this Market Monitor.

For the UK, our report shows cautious optimism – and refers to a 'silver lining' for the future of the industry, with building activity growing in many segments and falling insolvencies. A similar picture can be seen in the US, with visible growth in both residential and commercial building and insolvencies now at their lowest level since 2007.

Compare that to the story in France and Belgium, where insolvencies are on a steep upward path. In France the level of insolvencies in the construction industry is extremely high, and the same could be said of Belgium, where 2013 saw a 19% rise in construction bankruptcies. In the Netherlands too, the industry is dogged by low consumer demand and an overcapacity of non-residential buildings.

Why the difference? It could be that the UK and US are simply at a different stage of their overall economic recovery than France and Belgium. The UK and US were the first to feel the full impact of the credit crisis, the first to take remedial action, and are now the first to see positive results reflected in the outlook for their construction sector.

Germany is perhaps a case that differs from all of those others mentioned above. Yes, like the US and UK, German construction is faring well, but it has done so for several years as the German economy did not experience the depth of problems that others faced during the credit crisis. That is not to say that it doesn't have some issues to address, as its sawmill and wood machining segment suffers from high costs and overcapacity.

Two of the so-called 'emerging markets' also featured in this Market Monitor – Mexico and Turkey – have seen problems in their construction sectors. In Mexico, the government announced plans to support struggling house builders, while in Turkey insolvencies continue to rise.

Belgium

- **Payment problems persist**
- **Bankruptcies rose in 2013**
- **The ending of tax incentives will have an impact**

Credit risk assessment	strongly improving	improving	stable	deteriorating	strongly deteriorating
Trend in non-payments over the last 6 months				✓	
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months					✓
Development of insolvencies over the coming 6 months				✓	

Financing conditions	very high	high	average	low	very low
Dependence on bank finance		✓			
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector				✓	

Business conditions	strongly improving	improving	stable	deteriorating	strongly deteriorating
Profit margins: general trend over the last 12 months				✓	
General demand situation (sales)			✓		

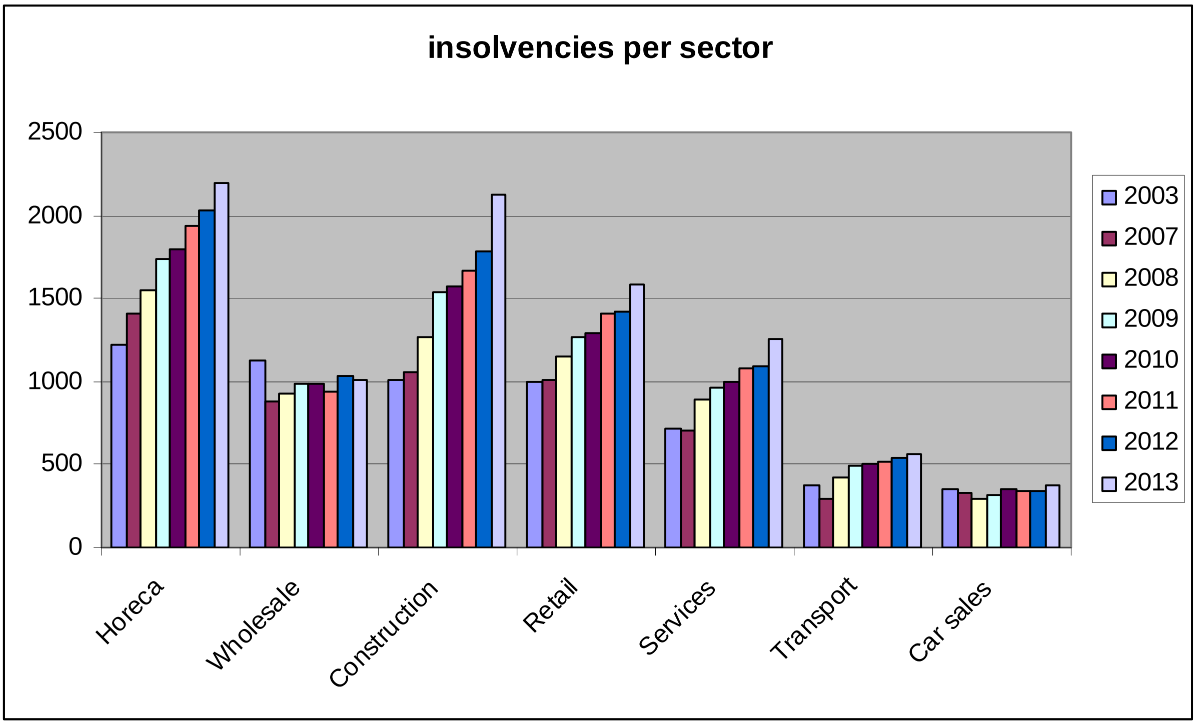
Source: Atradius

The Belgian construction sector has gone through difficult times since mid-2012, with poor demand, job losses and steeply rising insolvencies, pressure on prices, and deteriorating payment behaviour. Banks are generally more cautious about their lending, particularly to businesses in the construction sector.

In these circumstances, we have had to maintain a strict underwriting stance over the past year, especially for the civil engineering and renovation subsectors. While an economic rebound is forecast for 2014, with increased business and household spending, it will take some time for benefits to filter through to the construction industry. We are still receiving a very high number of notifications of non-payment in the construction sector, although this has stabilised in the last three months. In view of the tough market conditions, we do not expect any real improvement in the coming 6 months.

Payment terms in the construction sector are usually '60 days end of month' while cash payments with discounts are also common. Public bodies tend to have lengthy administrative and payment procedures, with subcontractors and suppliers frequently having to wait a long time to be paid. About 30% of construction companies have experienced deteriorating payment behaviour by their customers, and large contractors often pass the problems on to their subcontractors.

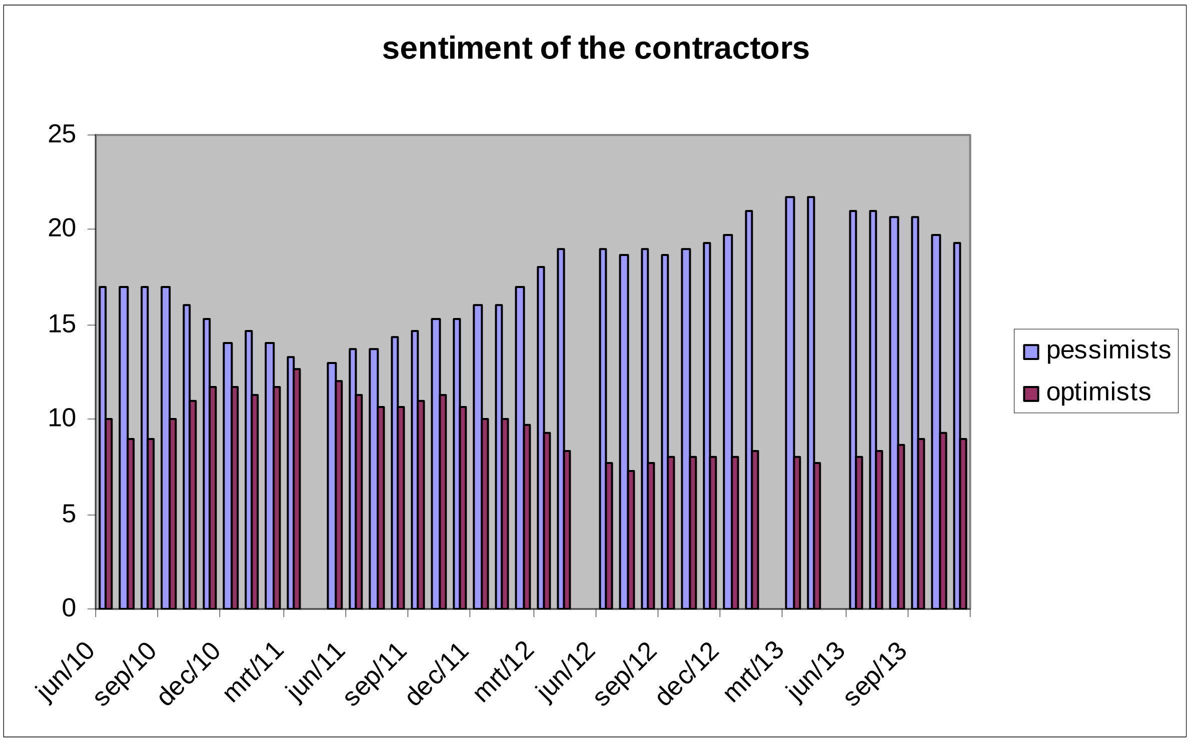
In 2013, 2,121 construction companies went bankrupt: a 19% increase year-on-year. The construction sector accounted for 17% of all business insolvencies, compared to 15% in 2008 and 11% in 2005. We expect the increase to continue in the first half of 2014, after which the trend should stabilise or even improve slightly. The businesses mainly affected are those engaged in infrastructure work and subcontractors in general.



Source: Statistics Belgium

The Belgian construction sector is expected to have contracted by 1.5%-2% in 2013. Civil engineering (especially related to road work) was hit by low investment by local government and cuts in municipalities' budgets. The renovation sector suffered from the economic downturn and the ending of the financial incentives for energy saving installations. The number of permits granted in 2012 for residential and non-residential new building was enough to maintain steady activity in these subsectors throughout 2013. However, this was not sufficient to compensate for the drop in the civil engineering and renovation segments.

Competition is fierce and companies are faced with bad payers. Those companies employing local people are often undercut by foreign companies or Belgian companies using foreign subcontractors. There is also uncertainty about the continuation of tax incentives for house ownership - the 'Woonbonus'. Its ending would decrease household budgets by 30%, and put negative pressure on real estate prices. This uncertainty is already deterring real estate investors. Added to this, high energy saving standards are making new residential construction overly expensive.



Source: Statistics Belgium

Based on the number of permits granted through September 2013, we can expect a slight increase in new residential construction (up 1%) and residential renovation (up 2.7%) this year. However, there will be a drop in non-residential new build construction (down 2%) and renovation (down 4.3%).

Belgian construction sector

STRENGTHS	**WEAKNESSES**
Demographic evolution	Fierce competition and tight market
Skilled workforce, reputation for innovation	Weak financial structures
Development of niche sectors	High labour costs

France

- **No rebound in sight**
- **Financing remains a major issue**
- **Insolvencies to level off – at best – in 2014**

Credit risk assessment	strongly improving	improving	stable	deteriorating	strongly deteriorating
Trend in non-payments over the last 6 months				✓	
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months				✓	
Development of insolvencies over the coming 6 months			✓		

Financing conditions	very high	high	average	low	very low
Dependence on bank finance			✓		
Overall indebtedness of the sector			✓		
Willingness of banks to provide credit to this sector					✓

Business conditions	strongly improving	improving	stable	deteriorating	strongly deteriorating
Profit margins: general trend over the last 12 months				✓	
General demand situation (sales)				✓	

Source: Atradius

As expected when we last reported on construction in Market Monitor a year ago, 2013 was a bad year for the French construction sector. Overall, output decreased 3.5%, according to the economic information provider Xerfi. The level of notified non-payments and claims was high, and insolvencies, already elevated in 2012, rose even more. Because of France's expected weak economic performance in 2014, construction activity should be subdued and, as a result, our underwriting stance remains generally restrictive. Under certain circumstances we are open to providing cover, but that is tied closely to the comprehensive financial monitoring of the buyer.

Financing is a major issue for French construction businesses: the result of a tough couple of years of poor performance and low demand. The situation is exacerbated by the generally bad payment behaviour in the industry over the last two years. While we have not seen an increase in notified non-payments in recent months, the level is still high. In addition, construction firms' finances are low as banks remain very selective with their loans, making access to short term credit difficult. Increasingly, suppliers have to substitute supplier credit for the lack of other financing solutions – and that underlines the key role that credit insurance plays.

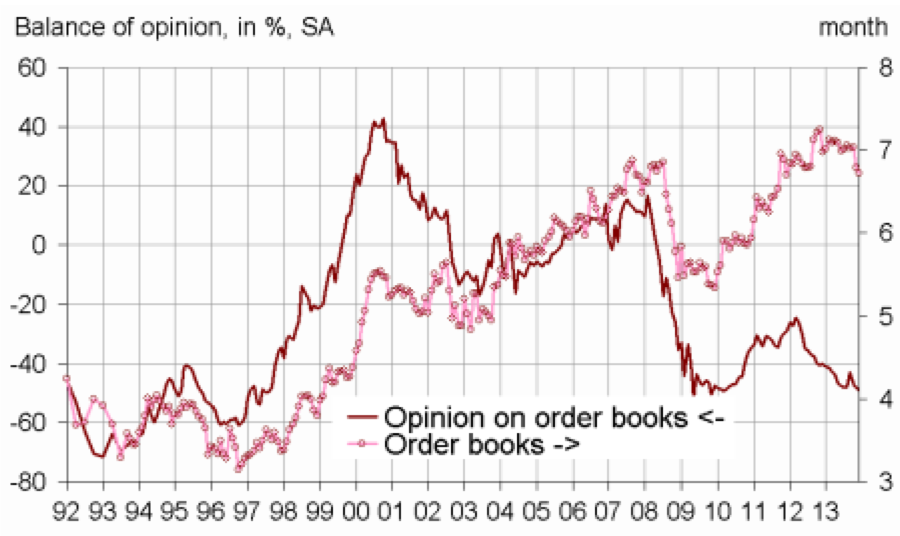
Prices and profitability are both being squeezed. Major players are putting pressure on their subcontractors, while there is growing competition from Italian, Spanish and Portuguese construction companies trying to gain market share in France to compensate for losses in their home markets.

With these problems, it comes as no surprise that construction has the highest share of total business insolvencies in France (about 30%). In 2013, those insolvencies reached very high levels, with numbers almost as high as in 2009, at the height of the credit crisis. The subsectors most affected are masonry and carpentry, both of which have been hit by the fall in new house construction, while timber – a poorly industrialised subsector - faces strong foreign competition.

While we do not expect construction insolvencies to increase further this year, this is small comfort in view of the already high numbers. However, given the weak outlook for construction in 2014 and the poor economic growth outlook for France (according to IHS Global Insight, GDP will increase just 0.5%), another increase cannot be ruled out.

The uncertain economic outlook will likely deter investment, and lower household purchasing power – the result of high unemployment and tough fiscal measures - will likely discourage house purchases. This year, construction output is expected to decrease again, by about 1.5%. The drop in building permits in 2013 (down 3.5%) should lead to a slowing of activity, at least in the first quarter of 2014, and make it difficult to restore currently low order books to healthy levels.

Order books



Source: INSEE

The number of new private housing starts is expected to range from 330,000 to 345,000 units: a slight increase of 2%. Public works may decrease by 4%, as a result of little investment (usually frozen in the first half of the year), a drop in state subsidies and restricted access to bank loans. We could therefore see a rise in the failure of construction firms dependent on this segment. The renovation and remodelling market will also suffer decreasing activity (down 0.2% in 2014 after a 1.1% drop in 2013) due to higher VAT. On the plus side, those engaged in energy efficiency work will benefit from tax incentives.

All this means that we must be cautious in our underwriting stance, but we still provide cover to our customers wherever it is reasonable and prudent to do so. In the current circumstances, it is vital that we closely monitor and review buyers to anticipate potential high risks to our customers.

- We focus on the cash situation and loan facilities available to buyers, especially smaller and mid-sized companies
- We review provisional 2013 financial statements
- Several key financial indicators must be analysed: the level of activity, margins and ability to fund working capital requirements. High financial costs are a key indicator of potential pressure on cash.
- We undertake special reviews of buyers in the wood, individual housing, and public works subsectors, as well as joinery, carpentry, insulation, and concrete activity.

French construction sector

STRENGTHS	WEAKNESSES
Structural lack of housing and the demographic development	Weak economic growth and measures to curb the high public deficit
Still low interest rates	Rising unemployment
	Costs rising faster than prices

Germany

- **The good performance continues into 2014**
- **Business insolvencies expected to decrease**
- **Restrictive underwriting for the wood/sawmill segment**

Credit risk assessment	strongly improving	improving	stable	deteriorating	strongly deteriorating
Trend in non-payments over the last 6 months		✓			
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months		✓			
Development of insolvencies over the coming 6 months		✓			

Financing conditions	very high	high	average	low	very low
Dependence on bank finance				✓	
Overall indebtedness of the sector			✓		
Willingness of banks to provide credit to this sector			✓		

Business conditions	strongly improving	improving	stable	deteriorating	strongly deteriorating
Profit margins: general trend over the last 12 months			✓		
General demand situation (sales)		✓			

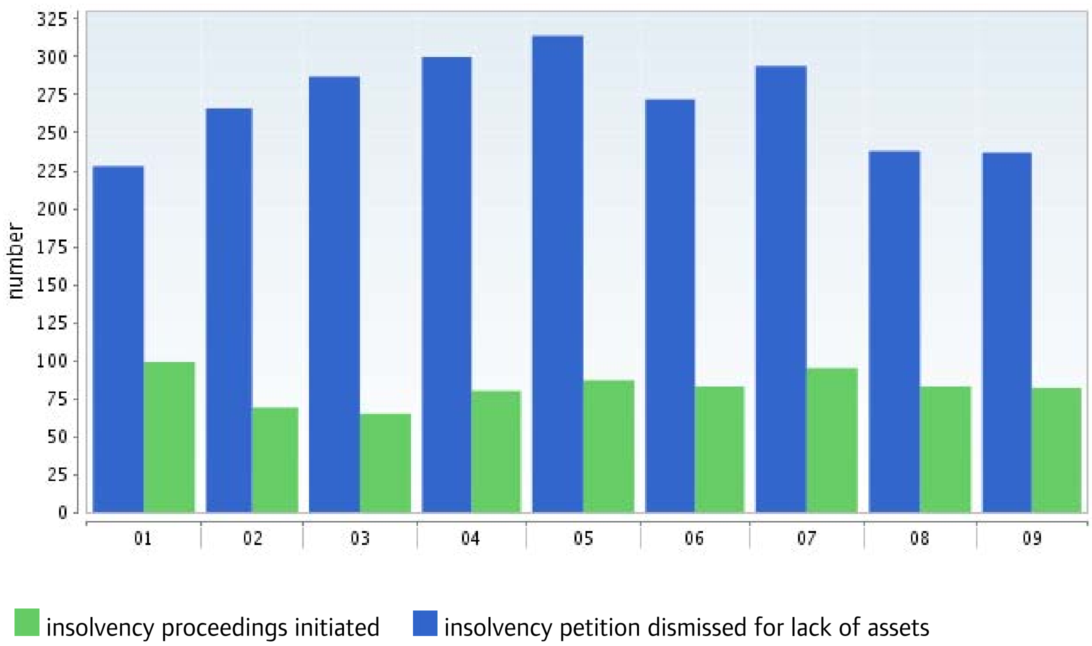
Source: Atradius

In recent years the performance of the German construction and construction materials sectors has improved, and the outlook for 2014 is positive. As a result, our underwriting view of the industry is quite relaxed. On average, payments in the German construction sector take around 45-50 days. Instances of payment default and insolvency fell in 2013 – a better outcome than expected in early 2013 - and we expect the number of business failures in the sector to decrease further in the first six months of 2014. However, the poor payment behaviour of public buyers remains an issue, as it puts a strain on suppliers' liquidity.

In the first quarter of 2013 the German construction industry was hit by adverse weather conditions, resulting in a year-on-year fall in turnover of nearly 10%. However, the industry rebounded during the year, boosted by residential building, while commercial construction levelled off. Overall, expectations are that nominal turnover in the German construction sector grew 2.5% in 2013, while the German Builders' Association forecasts another 3.5% increase in turnover in 2014, with growth in all main subsectors (residential construction: up 5%; commercial construction: up 2.5%; public construction: up 3.5%).

Although the construction materials subsector is naturally highly dependent on construction performance, its development is varied: construction materials subsectors engaged in reconstruction and modernisation have performed better than those active only in new building. Despite the industry's overall satisfactory performance, the sawmill/wood machining subsector continues to face problems, despite a global increase in demand for sawn timber products. The reasons are the high price of German round timber, high production and financing costs, overcapacity, and a disconnect between prices for log wood and sawn timber. This has led to negative results in 2012 and 2013 and the closing of several production plants. Therefore, and in contrast to other construction/construction material subsectors, our underwriting stance is very restrictive in this segment.

Construction sector: insolvency proceedings January-September 2013



Source: German Statistics Office

In general, when assessing buyer risk we take into account operating results, equity, liquidity and financing (e.g. the ratio of work in progress/advanced payments) and orders in hand. Despite our broadly open stance, we still consider construction to be a riskier sector than other industries, although credit insurance claims have decreased over recent years. Many construction companies – especially smaller ones – traditionally have weak equity ratios (the proportion of equity used to finance a company's assets) and limited financial scope. The average equity ratio in the German construction industry has improved slightly in recent years: reaching around 12-13% in 2013. According to Creditreform, construction insolvencies decreased by more than 11% in 2013, to 3680 cases. However, the proportion of insolvencies in the sector is still higher than in other industries (103 insolvencies per 10,000 firms compared to 55 per 10,000 in the manufacturing sector).

With less background information to work with, we are naturally very cautious when assessing the creditworthiness of construction/construction materials businesses that have operated for less than one year, unless they are part of, or a spin off from, a larger group.

While we normally review buyers annually, in more problematic subsectors (e.g. businesses focused solely on public clients) we hold additional reviews. Where we identify poor creditworthiness and negative operational results, our underwriting stance is naturally very restrictive.

German construction sector

STRENGTHS	WEAKNESSES
Solid performance since 2010 helped by a robust German economy	Very high number of small companies active in this sector
Significant amount of specialisation, especially in construction services	Limited access to international capital markets
Strong in technical innovations especially in the area of energy-efficiency	Somewhat high dependency on public works (e.g. road and railroad construction)

The Netherlands

- **Too early to judge whether payment behaviour has improved**
- **Businesses' financials will remain negative**
- **Despite signs of recovery, only a fragile stabilisation is expected**

Credit risk assessment	strongly improving	improving	stable	deteriorating	strongly deteriorating
Trend in non-payments over the last 6 months				✓	
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months				✓	
Development of insolvencies over the coming 6 months			✓		

Financing conditions	very high	high	average	low	very low
Dependence on bank finance	✓				
Overall indebtedness of the sector	✓				
Willingness of banks to provide credit to this sector					✓

Business conditions	strongly improving	improving	stable	deteriorating	strongly deteriorating
Profit margins: general trend over the last 12 months				✓	
General demand situation (sales)				✓	

Source: Atradius

We have seen deteriorating payment behaviour over the last few years in the Dutch construction sector, especially during the significant downturn of its performance in 2012 and 2013. With an adverse overall economic situation and more restrictive bank lending, payment times in the sector have increased to an average of 60 days. Since the last quarter of 2013 we have seen a levelling off of notifications of non-payment. However, it is too early to judge if payment behaviour is really improving.

Fierce competition means that the Dutch construction sector is still affected by price wars, and thus pressure on margins. The liquidity strength of many companies has weakened due to losses and impairment, with both solvency and liquidity under strain. As a result, the focus is increasingly on cash flow and working capital - and on tighter credit management.

Construction insolvencies seems to have stabilised in recent months, after a 22% year-on-year increase in 2012. However the level is still very high and we must therefore remain generally cautious in our underwriting stance towards this sector.

Although the Dutch economy and the housing market both show signs of recovery, we cannot yet relax our underwriting stance across all construction subsectors as it is still too early to assume a real turnaround. Consumer demand is still low and this will continue to affect residential building, while banks are maintaining their restrictive policy towards financing companies, especially in the building sector. Since 2013 as a whole was again a bad year for the construction industry, including the construction materials subsector, we expect most 2013 balance sheets to show no improvement.

Despite signs of a rebound, 2014 will be a transition year for the construction sector as volumes are not expected to pick up before early 2015. New building permits fell again in 2013: not a positive signal for production in 2014. Our most positive outlook is for orders and production to remain stable, while another slight decrease cannot be ruled out. Looking at specific subsectors, the immediate outlook for residential construction is bleak and we do not expect it to pick up before 2015. The same goes for both private and public non-residential construction, where there is still an overcapacity of office buildings. Construction businesses dealing with utility and public works are faring slightly better, but still with strong pressure on their margins. Low construction volumes and private spending continue to affect construction materials and we expect most businesses in this subsector to report negative results for 2013. However, as most companies have already anticipated the difficult circumstances expected in 2014 and 2015 and have reorganised accordingly (e.g. through lay-offs) they may report better results in 2014.

When assessing a buyer's creditworthiness, we require up-to-date financials (i.e. currently 2013), and details of their 2014 order book and payment experience. Additionally we seek details on the company's financing (covenants/securities) and the maturity dates of bank loans. Our aim is to maximise the insurance cover that we can give our customers, and in this respect third party securities, if available, can help.

Dutch construction sector

STRENGTHS	WEAKNESSES
Flexible work force (cost structure)	Pressure on margins/restrictive bank lending
Enhanced working capital management	Cost cutting measures of government/ future of mortgage interest deductibles unclear
	Feeble economic rebound expected
	Housing market still very weak

United Kingdom

- Insolvencies continue to decrease
- Business investments need to grow to maintain the recovery
- Smaller players still face financing problems

Credit risk assessment	strongly improving	improving	stable	deteriorating	strongly deteriorating
Trend in non-payments over the last 6 months			✓		
Development of non-payments over the coming 6 months			✓		
Trend in insolvencies over the last 6 months		✓			
Development of insolvencies over the coming 6 months		✓			

Financing conditions	very high	high	average	low	very low
Dependence on bank finance	✓				
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector			✓		

Business conditions	strongly improving	improving	stable	deteriorating	strongly deteriorating
Profit margins: general trend over the last 12 months			✓		
General demand situation (sales)		✓			

Source: Atradius

UK Construction began quietly in 2013 but, as the year progressed, there was a distinct improvement: first in the residential building subsector, then, in the second half of the year, the infrastructure sector was a key driver of sector growth. According to the Office for National Statistics (ONS) construction output grew 1% in 2013 after a massive slump in 2012, and is forecast to increase 3.4% in 2014 (see chart below). The Construction Products Association now believes that the output of construction products components and fittings grew 3.4% in 2013 and will rise 5.2% this year: well ahead of its projections of 2.7% and 4.6% just three months ago.

We are cautiously optimistic about the future as the strong house building market should help drive a construction recovery in 2014. The commercial sector is also picking up and, together with private housing and infrastructure, will help fuel industry growth over the next five years. Commercial construction (the largest subsector of construction in output terms) is forecast to grow by 2.4% in 2014 and 6% in 2015. This is supported by significant proposed investment in road, rail and energy projects throughout 2014 and beyond.

In the first nine month of 2013 construction insolvencies decreased, mainly in the medium-sized contractor (51-100 employees) segment, and this will give confidence to those businesses which suffered the most during the recession. The last quarter of the year and the first quarter of the new year are traditionally difficult times for the construction industry due to the Christmas shut down and the weather, and it will be interesting to see whether the reduction in insolvencies has continued into 2014.

While the situation is improving, business investment needs to grow to maintain this momentum. We realise that coming out of this lengthy downturn will pose some problems for construction businesses as they seek to finance any raw material price rises, volume increases and necessary capital expenditure spend. Despite reports of increased support from the financial institutions, there are still restrictions in financial support for those firms that need it most: i.e. smaller construction businesses. While larger players have little problem in securing finance, for smaller businesses further down the supply chain - where cash is essential - bank support is still lacking. This will be particularly important in future as raw material prices again increase and capital expenditure – delayed until now - may be needed to take advantage of the improvement in market conditions.

However, overall the industry is in a better place than it was 12 months ago. Therefore, in the short to medium term, our underwriting approach will be one of cautious optimism and this will be reflected in our assessment of risk. If anything, with the anticipated improvement in volumes and margins, we hope that this will allow businesses to pay and be paid more promptly, thus helping their cash flows.

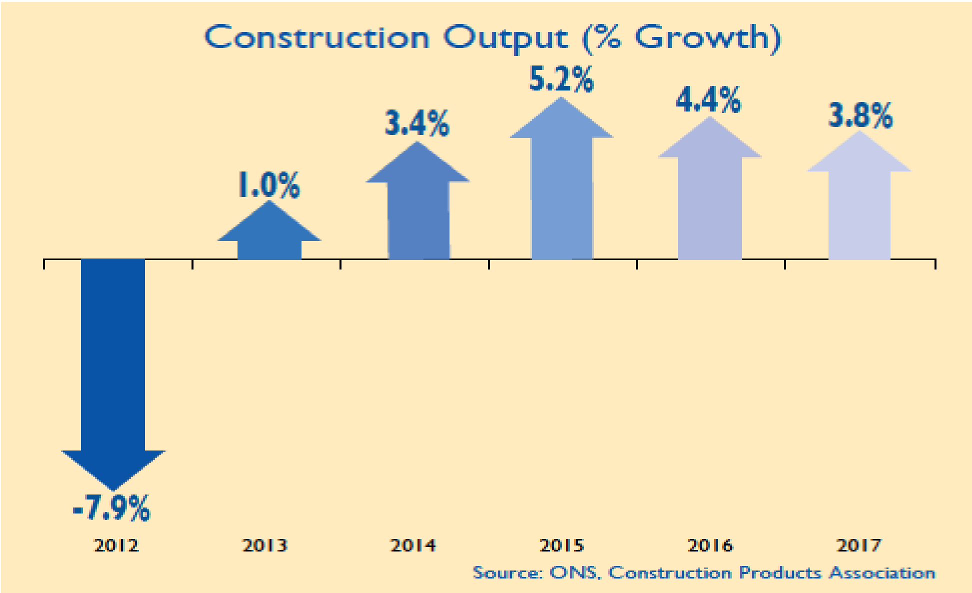
Payment delays worsened in 2013 as some of the major tier one contractors pushed their terms out to 90 and even in some instances to 120 days. This had the most damaging effect further down the supply chain: in effect, it meant that SMEs were helping to fund the working capital of much larger and more powerful businesses. However, as the anticipated volumes and margins improve in 2014, payment behaviour should also improve and managing cash flow should become easier.

As volumes and costs grow, construction contract prices will increase in 2014. As a result, contractors will become more selective in the work they bid for, and there is evidence that margins are improving as the suicidal tenders seen in the past 24/36 months decline. However, there could be trouble ahead for some contractors who had priced work before costs rose and will therefore be unable to recoup the subsequent rises in labour, subcontractor and materials prices as the contract progresses.

In view of the stretched payment terms, it is essential, when we underwrite risk, for us to assess if companies - particularly those further down the supply chain - have the resources to be able to withstand any delays in payment.

We expect construction insolvencies to continue to fall in 2014 - by about 3% - mirroring our prediction of an overall decrease in UK business insolvencies. However, we are still more cautious about the mechanicals and electrical construction subsectors. In both cases, we had seen desperate tendering price wars during the crisis, with gross margins on contracts under particular strain. This has caused some major insolvencies and large tier one contractors to leave those sectors due to overcapacity and tight margins.

The British construction sector still suffers from the downturn of recent years and caution is still advisable, but there now seems to be a real silver lining for the future. House building activity will be sustained by the economic rebound. Private housing repair, maintenance and improvement are expected to grow 3.5% in 2014 and then 4.0% each year until 2017. Public housing is forecast to rise 2.0% in 2014 and 2015, with marginal growth thereafter, as the government focuses on affordable, rather than social, housing. We also expect office construction work to grow 10% in 2015 and then by 7% in 2016 and 2017. A stronger recovery in London office projects and larger retail schemes that are in the pipeline are expected to fuel faster growth. Infrastructure building will be driven by a recovery in road work - where output has fallen by more than half in the past two years - and by further growth in rail construction.



British construction sector

STRENGTHS	WEAKNESSES
Continued strong housebuilding sector	Uncertainty about what will happen when some of the schemes that have been introduced to help the house building and construction sectors end
Economic recovery and improving consumer confidence	Raw material cost inflation and the ability of passing this on in the contract price.
Major projects such as Crossrail and Hinckley Point	Access to finance remains problematic

United States

- **The rebound continues, led by the housing market**
- **Insolvency numbers improve but are still high**
- **Barriers to bank lending are easing**

Credit risk assessment	strongly improving	improving	stable	deteriorating	strongly deteriorating
Trend in non-payments over the last 6 months		✓			
Development of non-payments over the coming 6 months		✓			
Trend in insolvencies over the last 6 months		✓			
Development of insolvencies over the coming 6 months		✓			

Financing conditions	very high	high	average	low	very low
Dependence on bank finance	✓				
Overall indebtedness of the sector		✓			
Willingness of banks to provide credit to this sector				✓	

Business conditions	strongly improving	improving	stable	deteriorating	strongly deteriorating
Profit margins: general trend over the last 12 months		✓			
General demand situation (sales)		✓			

Source: Atradius

Over recent years we have had to be fairly selective in our cover on the construction industry, as it was among the hardest hit during the recession - and the slowest to recover. However, the rebound that began in 2012 continued throughout 2013, and there is now scope to consider more cover for the sector. Proper due diligence is essential to gain the financial insight to allow us to consider larger requests for cover, but in general, our view is more positive than it has been for the past few years.

Payments in the US construction industry take 30-60 days on average, while 90 day terms are not uncommon. We are still seeing a mixture of prompt and slow payment trends, depending on the specific industry subsector. Private construction companies and general contractors typically experience most of the slow payments, as do companies that sell and lease construction machinery and equipment. But, overall, the number of notifications of late payment that we receive has decreased over the last year. We expect incidents of late payment to improve further in 2014 with a gradual market recovery.

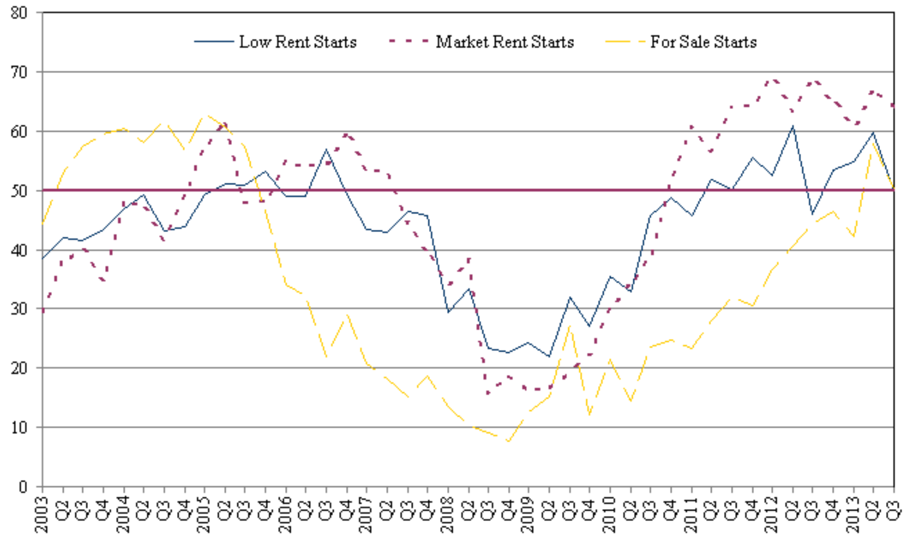
The same goes for construction insolvencies, which improved overall in the US last year. However, many companies have not recovered from the prolonged downturn and therefore, despite that improvement, we still expect to see a noticeable number of insolvencies in the construction industry this year. While there are some positive signs, since 2009 construction has had a higher rate of defaults and insolvencies than other US industries. Private residential contractors, public and private commercial contractors, and hardware stores have seen slightly more insolvencies, worsening the industry average. Nevertheless, we expect the number of construction insolvencies to decrease this year.

That improvement in the number of insolvencies and in payment behaviour is mainly due to the rebound in construction throughout 2013 that we expect to continue in 2014. At the start of 2013, when business began to gain speed, many speculators remained pessimistic for fear of the industry plummeting again. But, while the construction industry will always be cyclical, 2013 ended with sustained and even additional growth.

In the single-family residential construction subsector, both housing starts and completions exceeded forecast figures. The 2008 recession slowed new home construction for years, and the market is still playing catch-up, but there is visible growth in this sector. One concern is that of rising mortgage rates; so far the impact hasn't been great, as these rates are still at historic lows, but it's a factor to watch in 2014.

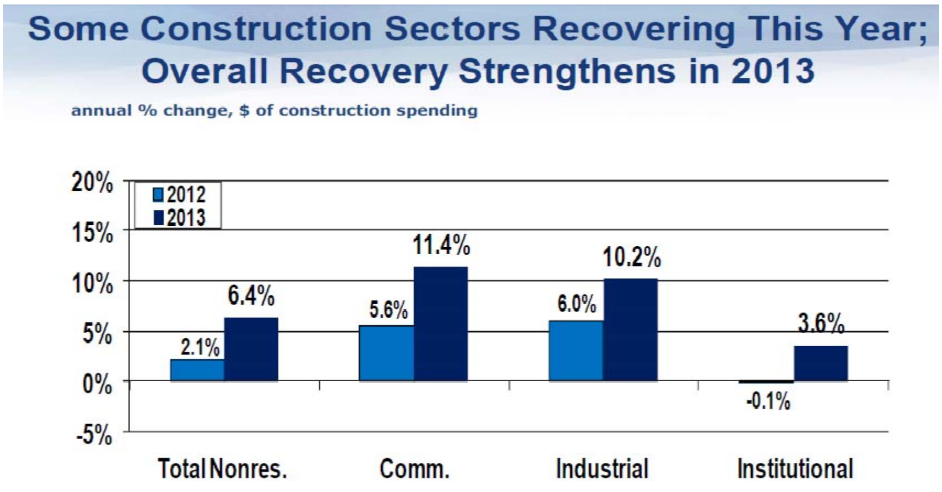
In terms of multi-family housing, the market has seen solid growth and, because of the current attractiveness to investors of multi-family housing, especially in major cities, this growth is expected to continue. During the initial recessionary years, demand for rental housing and multi-family housing increased as home foreclosures rose and single-family construction started to fall.

Chart 1
Components of the Multifamily Production Index (MPI)
(production in current vs. prior quarter)



Source: National Association of Home Builders

Commercial and public construction activities began to pick up in 2013. The growth here is attributable to new retail stores, warehouses, shopping centres and hotels. With a stabilising economy in the US and strengthening consumer confidence, families are beginning to spend more, including spending on vacations. New office construction is lagging behind as securing finance is still difficult. Construction of schools and healthcare facilities is decreasing because of reduced government spending, lowered budgets, and uncertainty over the Affordable Care Act. However, there has been a modest rise in public works, such as new bridge construction, as this sector was not impacted by the sequester and other government spending cuts. The federal transportation bill has also contributed to stabilisation.



Source: AIA Consensus Construction Forecast Panel

We expect construction activity to increase in 2014. The housing market, recovering from record lows, initially paved the way for construction growth. Now many non-residential building markets are turning the corner too: making for optimistic 2014 forecasts. In the case of large construction deals, there is a high dependency on bank financing and while in recent years it has been difficult to secure bank credit, especially for large construction deals, we are seeing this barrier easing. Some regulations require certain documents and restrictive covenants, but the fact that banks are opening their books a little more to the construction industry is hopeful.

However, we also expect that producer prices will rise in 2014 as the improved outlook for the global economy leads to an increase in materials prices after a flat 2013.

In summary, we assess buyers in this sector in this way:

- Cover will be considered if we can see evidence of favourable trade history, financial statements or other credit/financial insight.
- Reduction or withdrawal of cover must be considered if buyer shows significantly worsening results, including losses, heavy debt levels, problems with working capital, cash flow or liquidity, and also if their payment trends are slow and deteriorating.
- Where financial information is required, we will look for signs of progressive and profitable operations, positive working capital and cash flow, and satisfactory debt to net worth leverage. We also take into account less measureable aspects such as goodwill, health/pension liabilities and litigation issues.
- We consider whether other forms of risk mitigation - such as Uniform Commercial Code (UCC) filings, letters of credit, increased co-insurance and decreased indemnification, and shortened terms of sale – will assist us in agreeing cover.

US Construction Sector

STRENGTHS	WEAKNESSES
We are seeing the greatest recovery in residential construction, with strong single-family improvements and very optimistic multi-family construction growth. In non-residential/commercial construction there is increased activity in bridges, hotels, retail outlets, and warehouses	Federal government budget cuts and other restraints have hurt commercial contractors and projects. Concerns over the Affordable Heath Care Act have slowed construction activity in the healthcare sector significantly
Consumers are less reluctant to spend money. The pace of economic growth is maintainable and should not peak and then suddenly crash. 2014 is expected to see the most growth since 2008.	Increased industry activity will call for additional job openings. However the recession forced many skilled labourers out of the industry and so recruiting workers with the right skills could prove difficult
There are further signs of a weakening link between residential and non-residential construction, which is a sign of hope for the economy	Potential for inflation to rise if growth accelerates too rapidly

Mexico

- **More payment delays**
- **Public construction outlook encouraging**
- **Housing subsector still faces troubles**

The Mexican construction sector suffered a downturn in 2013, with production value down 3.6% year-on-year between January and October. While we expect a rebound of more than 5% in 2014, driven mainly by non-residential building and infrastructure activity, our underwriting approach is still quite restrictive because of last year's poor performance; we received more notifications of non-payment last year than in 2012.

On average, payments in the construction industry take between 45 and 120 days. It is common for payments from buyers in this sector to be slow, especially in the case of public infrastructure projects.

One factor that made a big – and negative – impact on the industry last year was the change of administration following the presidential and parliamentary elections. However, while that change led to delays in decisions on public building projects, the expectations for public investment in infrastructure for the coming year are encouraging:

- A proposed capital expenditure for 2014 that is 14.3 % higher in real terms than in 2013
- A physical investment budget that is 10.1 % higher in real terms than in 2013
- The most important 500 investment projects planned to amount to almost MXN 500 billion (EUR 28 billion)
- Reforms in the energy sector could lead to additional growth of 1.3% and 80,000 additional jobs.

In contrast, the housing subsector is likely to remain in difficulty – at least in the short term. House builders were forced to restructure debt in the first half of 2013 and cash shortages forced some major companies into bankruptcy in the second half of the year. As a result, the capacity to expand housing construction will be constrained, but the government has announced plans to provide financial support such as credit lines and guarantees for bond issuances to house builders to encourage new housing construction. This should help to stabilise the market, and create a better outlook for 2014. However, with cash flow severely constrained, there will be only a slow recovery unless further consolidation or government measures are put in place.

For cross-border transactions in any sector we recommend that our clients obtain a Pagaré (promissory note), preferably guaranteed by the owner of the company, to protect them from potential currency volatility and the possibility of a buyer experiencing liquidity problems. Without a Pagaré, the buyer would give priority to local suppliers, paying them first.

Turkey

- **Shrinking profit margins**
- **More insolvencies in 2013**
- **New tax legislation hurts business**

Turkey has seen considerable growth in activity in the construction sector in recent years. Construction is a key sector in Turkey and one of the main drivers of both private and public investment. The sector grew 4% in the first nine months of 2013, due mainly to public investment. Residential and non-residential construction activity is forecast to increase around 5% in 2014.

Despite this positive news, as in 2012 the industry still faced some serious problems last year. Profit margins continued to narrow as a result of higher competition and rising unsold stocks of houses. Solvency and liquidity problems persisted, with many construction companies highly indebted. Payment delays increased further in 2013 and we expect them to continue to rise this year, as new tax laws impact sales and currency risk. The amount of non-performing loans in the construction sector increased 59% year-on-year between March and December 2013 and are likely to increase further in 2014.

The new tax legislation includes a VAT increase on new houses licensed after the beginning of 2013, increasing prices by 5-7%. We therefore expect the increase in insolvencies seen over the last six months to continue into 2014.

We have been vigilant in our underwriting strategy towards this sector since early 2013, and the adverse developments and insolvencies mean that we must remain watchful in the future. Notified non-payments have increased over the last six months and are expected to continue to do so in 2014.

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