

A wide-angle photograph of a construction site at dusk or dawn. In the foreground, there are stacks of wooden beams and construction materials. In the middle ground, three construction workers wearing hard hats and safety vests are standing and talking. In the background, a large yellow tower crane is visible against a sky with a warm, orange glow from the setting or rising sun. The building's steel framework is visible in the distance.

# The Allianz guide to Target Marketing

Take a look inside this report for more information about the **top three target marketing** industries.

- Agriculture
- Professional services
- Commercial real estate
- Construction
- Manufacturing
- Technology

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TARGET MARKETING:

# Construction Industry

2021: 3Q - 4Q

## CONSTRUCTION

**Industry** The North American Industry Classification System (NAICS) classifies companies in the construction industry into three broad categories:

- Building Construction (residential and nonresidential)
- Heavy and Civil Engineering (infrastructure)
- Specialty Trades (industrial-specific)

Trends and concerns for the companies that engage in these areas also affect – to varying degrees – companies in other related industries, such as material and tool suppliers (manufacturing), architects, and engineers (professional services).

**Trends** The existing supply of houses is 4.4 months as of April 2021, down from a high of 12.2 months in January 2009, and the lowest supply since the summer of 2003.<sup>1</sup> Low housing supply will increase demand for residential construction. More than \$1 trillion in spending was recently proposed in Congress relevant to the construction industry, primarily in new and modernized infrastructure, with a substantial amount for affordable housing and public architecture.<sup>2</sup> Revenue expectations for the next 12 months improved in 1Q 2021, with 36% of contractors expecting their revenue to increase – up from 25% of contractors anticipating more revenue last quarter.<sup>3</sup>

**Concerns** Davis-Bacon and Related Acts (DBRA) requires contractors to pay **prevailing wage (e.g., union) rates** for all federally funded contracts, even if the contracted labor is non-unionized (87.3% of construction workforce<sup>4</sup>). Recent executive orders direct **strict enforcement** of these provisions.<sup>5</sup>

80% of contractors continue to experience COVID-19 related **project delays** in 1Q 2021, down 3 points since last quarter.<sup>6</sup> Most contractors (71%) continue to experience at least one **product shortage**, steady from last quarter. Concerns over wood/lumber shortages are easing, down to 22% of contractors (from 31% last quarter<sup>7</sup>).

35% of contractors say **steel and aluminum tariffs** will have a high to very-high impact over the next three years – up sharply from 24% last quarter.

**Finding skilled workers remains a challenge** for contractors in 1Q 2021 – 85% agree, up from 83% last quarter. 46% of contractors report a high degree of concern about their workers having an **adequate skill level**, up 10% from 4Q 2020. And 46% of contractors plan on hiring workers over the next six months, up from 32% a year ago – which will increase competition for workers.<sup>8</sup>

34% of contractors report **turning down work due to labor shortages**, a decrease from 39% last quarter.<sup>9</sup> Contractors appear to be hiring less-qualified workers in order to meet ongoing demand.



<sup>1</sup> Monthly Supply of Houses in the United States (MSACSR), Federal Reserve Bank of St. Louis, <https://fred.stlouisfed.org/series/MSACSR>.

<sup>2</sup> Fact Sheet: The American Jobs Plan, 3/31/21, <https://www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan/>.

<sup>3,6-9</sup> U.S. Chamber of Commerce Commercial Construction Index Q1 2021, [https://www.uschamber.com/sites/default/files/cci\\_2021\\_q1\\_report.pdf](https://www.uschamber.com/sites/default/files/cci_2021_q1_report.pdf).

<sup>4</sup> United States Department of Labor, Bureau of Labor Statistics.

<sup>5</sup> Buy American executive order.

| ISSUE  | OPPORTUNITY  |
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| <p>Obtaining surety bonds is a consistent key issue in the construction industry. Government projects require them, as will almost any major private contract.</p>   | <p><b>Review buy-sell agreement and funding:</b> Surety providers want to see a well-developed and maintained business continuation plan.</p> <p><b>Informally funded NQDC/SERP:</b> Surety providers are also looking for low debt-to-asset ratios. Life insurance cash surrender value may be included in the surety providers' definition of "working capital," which is a key factor in obtaining a surety bond.</p> <p><b>Key person life insurance:</b> Surety companies will want to have a sufficient level of comfort that the death of the owner, or other key person, won't cause financial stress to the business such that it risks their ability to complete projects.</p> |
| <p>With current low inventories and high demand, home builders will have opportunities that may provide substantial revenue, profit, and valuation increases in the coming years.</p>  | <p><b>Life Insurance as a Financial Engine<sup>SM</sup>:</b> Potential increases in tax rates and the loss of existing tax advantages mean business owners should be evaluating tax-efficient options as well as basis-shifting strategies.</p>  |
| <p>A broadly improving construction marketplace – especially with an infrastructure deal – means other construction businesses will see a similar increase in revenue, profit, and valuation. Interest in mergers &amp; acquisitions may increase.</p> | <p><b>Business continuation bonus plan:</b> Retaining key employees through ownership transition is vital.</p>   |
| <p>There are significant ongoing concerns about finding and retaining workers with adequate skills to satisfactorily complete available work.</p>  | <p><b>Key employee compensation strategies:</b> Evaluate HR options for attracting and retaining skilled employees.</p> <p><b>Evaluate creditor protection strategies:</b> Being forced to rely on less-skilled workers raises liability concerns. Assets outside the business with creditor protection advantages may be appealing.</p>   |

Life insurance death benefit is generally income-tax-free when passed on to beneficiaries.

Fixed index universal life insurance requires qualification through health and financial underwriting.



## ADDITIONAL TALKING POINTS / PLANNING OPPORTUNITIES:

- **Construction companies that are family-owned businesses present a number of business succession opportunities.** When multiple children are the intended successors, but they have different skill sets and aptitude, the business may be better suited for operating as separate units than other forms of businesses. Construction companies are often made up of three different parts: 1) business operations (e.g., contracts, finances, project management, etc.); 2) equipment owned to complete the projects; and 3) the land on which the business operates (e.g., equipment storage, office space, etc.). The owner may divide the business into separate business entities, execute long-term contracts between the separate entities, then gift or sell the separate entities to their children. This may have a number of tax and non-tax advantages.
- **We may be in a period where revenue for construction companies has been lower over the past year, but may increase substantially in the years ahead** as tariffs are eliminated, government spending on infrastructure increases, supply chains rebound, and labor shortages are addressed. This creates an opportunity to transfer business interests to family members at lower valuations. For example, if the business interest is valued based on the three-year average EBITDA, and the past year had an unusually low EBITDA, an owner could gift or sell an interest with a justifiably low value.
  - Family business succession planning presents numerous life insurance opportunities, such as amending and funding buy-sell agreements, new key employee life insurance, business continuation bonus plans for key employees, etc.
- **Construction companies, and the many businesses that support them, may experience a shift in demand** for the type of projects available and the way they conduct business.
  - 1) Political efforts are being made to substantially increase spending on “green” construction projects. According to the Global Alliance for Buildings and Construction, 28% of global CO2 emissions come from building operations, and another 11% come from building materials and construction. This has caused a global push toward more energy efficient construction practices, net zero carbon buildings, and other efforts that could present challenges and opportunities for the construction sector.
  - 2) The COVID-19 pandemic may change demand for the types of projects available to construction companies. Demand is expected to increase for warehousing, life science facilities, data centers, etc., but possibly decrease for office space and retail space. These changes may be temporary or long term.
    - In order to take advantage of these new opportunities, construction companies will need strong human resources talent, project managers with experience in new markets, and other talent the business may not currently have under their roof. This presents opportunities to discuss key employee compensation strategies, such as bonus plans, split-dollar, and nonqualified deferred compensation.

### RESOURCES: Click these links to learn more.

- National Association of Homebuilders
- Associated General Contractors of America
- Associated Builders and Contractors, Inc.



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TARGET MARKETING:

# Manufacturing Industry

2021: 3Q - 4Q

## MANUFACTURING

### Industry

The Manufacturing sector is composed of establishments engaged in the mechanical, physical, or chemical transformation of materials, substances, or components into new products.<sup>1</sup> This includes establishments which process materials or which contract with other establishments to process their materials for them.

At the end of 1Q 2021, the Bureau of Labor Statistics reported 12.3 million people employed in the manufacturing sector, with a 5.2% industry unemployment rate, and 708,000 job openings.

Trends and concerns for companies in the manufacturing sector also affect companies in related industries, such as construction companies which use their products, and retail companies which bring them to market.

### Trends

Nearly \$400 billion in proposed infrastructure spending will potentially impact the manufacturing sector. This includes money for electric vehicle investments, semiconductor manufacturing and research, rural and clean energy manufacturing, and investments for dislocated workers and apprenticeship programs.<sup>2</sup>

By 2025, the number of connected devices in the automation sector is expected to increase by a factor of 50. In the U.S., about 35% of manufacturers use and collect data from smart sensors to enhance their manufacturing processes.<sup>3</sup>

### Concerns

97% of manufacturing firms report an awareness of the **aging of the manufacturing workforce** – 78% say they are very or somewhat concerned about it, and 97% are concerned over the **loss of institutional and technical knowledge**.<sup>4</sup>

In response, 37% of manufacturers project that they will **increase their spending** in Human Resources and Talent Development to better recruit, develop, and retain the workforce they will require.<sup>5</sup>

Manufacturers have identified supply chain stability as a critical factor for the recovery of the manufacturing industry. Even if demand picks up, supply chain issues could slow down the recovery for the industry as a whole.

**Slowing mergers & acquisitions activity** has hit the manufacturing industry harder than others. This decreased demand may cause downward pressure on earnings multiples for manufacturers due, below the relatively higher multiples that had been consistent over the last few years.<sup>6</sup>



<sup>1</sup> North American Industry Classification System.

<sup>2</sup> Fact Sheet: The American Jobs Plan, 3/31/21, <https://www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan/>.

<sup>3</sup> Internet-of-Things (IoT) Market in Manufacturing – Growth, Trends, COVID-19 Impact, and Forecasts (2021 - 2026), Mordor Intelligence.

<sup>4</sup> The Aging of the American Workforce: Challenges and Best Practices, July 2019, The Manufacturing Institute.

<sup>5</sup> 2021 BDO Manufacturing CFO Outlook Survey.

<sup>6</sup> Pepperdine University, Pepperdine Digital Commons, Pepperdine Private Capital Markets Report, 5-2-2020, 2020 Private Capital Markets Report, Craig R. Everett.

| ISSUE  | OPPORTUNITY  |
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| <p><b>Labor skill gap – the manufacturing workforce is aging, and their intellectual and technical knowledge are not being replaced.</b></p>   | <p><b>Employee retention plans:</b> A commonly used solution is to create a talent development system (e.g., in-house training, internships, and apprenticeships) to develop new skilled employees. It is very important that companies are able to retain these employees after committing money to their training.</p>   |
| <p><b>Efficiencies created by the increased implementation of Internet of Things (IoT) technologies have necessitated a change to more tech-related job skills. Companies need to adapt or risk losing out to competitors.</b></p> | <p><b>Business succession/estate planning:</b> When leaving the business, owners should consider providing an easily accessible source of funds their successors can leverage for the cash necessary to adapt. Life insurance may be an appropriate option.</p> <p><b>Key employee compensation:</b> Plans need to adapt to changing needs and the increasing prevalence of technology-centric executives.</p>   |
| <p><b>The reliability of the supply chain will continue to be a major driver of the success of manufacturing companies as they work to get their products into the hands of retailers and consumers.</b></p>                       | <p><b>Key employee compensation:</b> Plans need to consider what is necessary to recruit and retain employees with strengths in supply-chain management.</p>   |
| <p><b>Merger &amp; acquisition activity for manufacturing companies has lagged behind other industries.</b></p>  | <p><b>Business continuation bonus plan:</b> Provides incentives for key employees to remain with companies following a transition of ownership, maximizing a company's potential value and appeal to outside buyers.</p> <p><b>Nonqualified deferred compensation:</b> Avoid NQDC plans with "change of control" triggering language. Buyers are less likely to make an acquisition if key employees are able to access their NQDC balances when the transaction occurs.</p> |

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## ADDITIONAL TALKING POINTS:

- **There are a growing number of U.S. universities now offering logistics and supply-chain management** as an undergraduate major or master's program. Employers may need to consider key employee compensation plans that are appealing to younger key employees, e.g., those with younger children, new homes, etc.
  - A key employee bonus plan may be better suited for younger employees as opposed to nonqualified deferred compensation plans.
- **Current financial decisions manufacturers are facing:** The 2017 Tax Act included a number of provisions relating to immediate expensing of certain assets and bonus depreciation. Manufacturers, more than most other industries, will benefit from these provisions. For example, the act expands expensing of Sec. 179 property – allowing taxpayers to immediately expense up to \$1 million of the cost of certain depreciable assets acquired and placed in service in the tax year. Sec. 179 property includes equipment and other assets that are often substantial expenses for manufacturers. These provisions may be repealed by the new administration as they seek additional tax revenue. Even without a repeal, many of these new laws are set to end at the end of 2025 or 2026.

Manufacturers may want to take advantage of these tax laws while they are available and that may require contributing substantial cash flow towards the purchase of new equipment, or adding debt as they finance these purchases.

- **The Internet of Things** is just one element of what is being referred to as the Fourth Industrial Revolution, or Industry 4.0. Other critical elements include big data, advanced robotics, cloud computing, and additive manufacturing (e.g., 3D printing of parts). Manufacturers are facing the challenge of keeping up with these advances. The need for additional capital to pay for new technologies may lead to more private equity deals.
  - In order to maintain the flexibility to enter into such deals, business owners may want to consider alternatives to offering key employees stock or stock options. These may include plans such as phantom stock plans or stock appreciation rights plans informally funded with cash value life insurance.

### RESOURCES: Click these links to learn more.

- National Association of Manufacturers
- Alliance for American Manufacturing



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TARGET MARKETING:

# Agriculture Industry

2021: 3Q - 4Q

## AGRICULTURE

### Industry

The Agricultural sector consists of establishments primarily engaged in growing crops, raising animals, harvesting timber, and/or harvesting fish and other animals from a farm, ranch, or their natural habitats.<sup>1</sup>

At the end of 2020, the Bureau of Labor Statistics reported nearly 300 million employed in the agricultural sector, including more than 235 million farmworkers and laborers, 12.6 million operation supervisors/managers, and nearly 52 million equipment operators and drivers.

Trends and concerns for agricultural companies also affect companies in related industries such as equipment manufacturers, retailers, and agricultural input suppliers.

### Trends

The American Rescue Plan – signed into law on March 11 – contains approximately \$23 billion in food and agriculture spending as well as funding for rural health care and supply chain resiliency.<sup>2</sup>

Farmers and ranchers have a great deal of interest in commodity prices, which can vary greatly even within a single year based on numerous factors which are outside of their control or influence. Corn, soybeans, and wheat are all at their highest prices in more than seven years due to increased foreign demand after China and Brazil experienced disappointing yields.

Federal Estate Taxes currently pose little concern for farm and ranch owners. The USDA Economic Research Service estimates only 50 farm/ranch estates owed federal estate taxes in 2020.<sup>3</sup>

### Concerns

Because they commonly inherit their land and depreciate their equipment, farmers and ranchers tend to have a lot of low- and zero-basis assets. Basis management is a more pressing concern than estate tax, and a **proposed loss of the basis step-up** would have a significant impact on the agricultural sector.

Many farm and ranch operations have remained in the control of the same family for several generations. “Bloodline” planning, which **keeps control in the same family**, remains a common goal for most owners who have an emotional attachment to their land and view their situation very differently than non-agriculture business owners.

The greatest obstacle for keeping family farms within families is not tax issues – though it could be in the future. It is the **lack of interest** of many in the next generation to continue farming.



<sup>1</sup> North American Industry Classification System.

<sup>2</sup> U.S. Department of Agriculture, Fact Sheet: United States Department of Agriculture Provisions in H.R. 1319, the American Rescue Plan.

<sup>3</sup> USDA Economic Research Service, <https://www.ers.usda.gov/topics/farm-economy/federal-tax-issues/>.

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| ISSUE  | OPPORTUNITY  |
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| <b>Interest in planning to keep the family farm in the family</b>  | <b>Life insurance trusts:</b> A trust can be specifically designed to own farmland and allow family members continued control of the operation. Life insurance's death benefit, which is generally income-tax-free, can provide liquidity for taxes as well as a cash source for maintaining operations.   |
| <b>Next generation is losing interest in taking over family farms</b>  | <p><b>Pass farm to interested children:</b> A life insurance death benefit can be used to equalize inheritance to children who will not be involved.</p> <p><b>Buy-out agreement:</b> Children remaining involved can buy out those who are not. Set a price and terms ahead of time to avoid family discord, and use the life insurance death benefit to meet purchase obligations created under the agreement.</p> |
| <b>Farmers and ranchers have an emotional attachment to their land; it's not just any other asset.</b>                                       | <b>Parcel the land:</b> Pass on parcels of equal value to children. Children who wish to continue farming will have first right to a lease agreement. Farm children get operation income; non-farm children receive lease income.  |
| <b>Business success is variable and based on often uncontrollable factors</b> (e.g., weather, commodity prices, international demand, etc.). | <b>Flexible estate planning:</b> Strategies like the Spousal Lifetime Access Trust provide the needed death benefit protection while retaining access to the policy's available accumulation values (indirectly through the spouse).   |

## ADDITIONAL TALKING POINTS:

- **Financial professionals working with agricultural businesses should be familiar with IRC Sec. 2032A** (special use valuation), which allows agricultural landowners to determine the value of their property based on how the land is used rather than the potential development value for estate and gift tax purposes.
  - **Conservation easements are a popular topic for farm owners who own substantial land.** By donating a conservation easement to a charitable land trust, the owner may realize a substantial income tax deduction. This may be an appropriate point of conversation if they are expecting to realize a substantial income tax event in a given year (e.g., Roth conversion, selling farm to children, etc.).
  - **A current talking point among farmers is the tax credits and depreciation available for installing solar collection equipment.** In 2021 there is a 26% tax credit.
- In addition, the Rural Energy for America Program (REAP) provides guaranteed loan financing and grant funding to agricultural producers and rural small businesses for renewable energy systems or to make energy efficiency improvements.
- **Deferring taxes on the sale of land is a big topic for those in agriculture.** There are strategies from the simple to the complex, from the well-established to those the IRS will question. These include installment sales, 1031 exchanges, Delaware Statutory Trusts, self-cancelling installment sales, private annuities, deferred sales trusts, and monetized installment sales. Although we do not provide tax advice, gaining familiarity with each may be worth the effort if you intend on working in this market. Conversations regarding these strategies may be part of a wider business succession discussion which will present life insurance opportunities.

## RESOURCES: Click these links to learn more.

- U.S Department of Agriculture
- American Farm Bureau (the news section under the "Latest" tab is a good resource for current issues and opportunities in agriculture)
- IRS Publication 225, Farmer's Tax Guide
- Trends in price of corn, Macrotrends Data
- Trends in price of wheat, Macrotrends Data
- Trends in price of cattle/beef – U.S. Department of Agriculture



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