CFOs Express Growing Concern As Another New Year Approaches

In what has become an annual rite of passage, the average construction firm CFO is expressing concern with the arrival of the new year. This has been a pattern for a number of years, with CFOs typically exhibiting intensifying angst as the calendar year progresses and then indicating brighter prospects during the early stages of the following year.

It is conceivable that that will happen again, but the fact of the matter is that construction CFOs have a growing list of concerns to consider. At the top of the list is the ongoing lack of available human capital. Various surveys indicate that labor costs are now rising faster than four percent per annum among construction firms, with some indicators suggesting that average hourly earnings are growing closer to five percent. On top of that, the growth of healthcare costs appears poised to accelerate and many CFOs expect borrowing costs to be higher one year from now.

Fully three quarters of CFOs (precisely 75%) expressed significant concern regarding skills shortages during the December 2015 administration of the CONFINDEX Survey. By far, that remains the most pervasive challenge facing CFOs today. During the prior survey administration, however, 81 percent of CFOs expressed concern regarding skills shortages. The fact that slightly fewer CFOs are concerned by shortages of human capital is likely rooted in regional economic dynamics. With energy prices collapsing over the past year, several communities around the nation have experienced sharp declines in capital investment, including reduced levels of nonresidential construction. Economists have indicated that states such as North Dakota, Oklahoma, and Alaska are now at risk of recession, while West Virginia is already in recession. Accordingly, CFOs from these and similarly situated areas are less likely to be concerned by skills shortages than they would have been during earlier periods.

Despite the ongoing reductions in energy-related capital investment, there generally remains relatively little concern regarding the demand for construction services. Both residential and nonresidential construction spending data reveal growing spending momentum. In several nonresidential construction categories, there is evidence that public sector outlays are beginning to expand more forcefully.

The Construction Financial Management Association (CFMA) conducts its CONFINDEX Survey each quarter. The survey’s most recent iteration is associated with an Overall Index reading of 128. That is down from 131 during the prior quarter and down 3 percent from the same period one year prior. However, the index reading is still 62 percent higher than its December 2008 reading of just 79.

During the most recent quarter, no sub index value expanded. For instance, the Business Conditions Index, which reflects responses to a variety of questions including those regarding backlog and current sales, declined more than six percent during the fourth quarter to a reading of 136. The Business Conditions Index has fallen by nearly 11 percent over the past year, which represents the largest year-over-year decline in any of the indices, but is still up 116 percent from the December 2008 reading of 63.

The Financial Conditions Index has come in at 121 for three consecutive quarters. This index is up 4.3 percent from a year ago and was the only sub index not to decline during the December 2015 survey administration. Only eight percent of CFOs are highly or very concerned regarding the availability of financing for projects, down from 10 percent in the previous quarter. For now, the availability of financing is not an emerging headwind for the construction industry, though there are indications from other industries that capital has become a bit more difficult to access of late.

The Current Confidence Index fell 2.9 percent to a reading of 132. The index is still up by more than two percent from a year ago and is more than double its December 2008 reading of 65. The index’s decline appears to reflect a bit of softening in economic conditions in natural resource intensive states.

Perhaps the most telling sub index is the Year-Ahead Outlook Index. This index fell by 2.4 percent and is down by nearly 10 percent (9.6%) from a year ago. While declines in the Year-Ahead Outlook Index are not unusual at this time of year, CFO comments indicate growing focus on emerging cost pressures.

While most CFOs indicate that profit margins are either improving or stable, confidence regarding the year-ahead has slipped just a bit. During the third quarter of 2015, 38 percent of CFOs indicated that profit margins would be significantly or slightly better in one year. During the fourth quarter, this proportion fell to 33 percent. While just six percent of CFOs expressed a belief that their profit margins would deteriorate over the next year during the third quarter’s survey administration, the fourth quarter, 11 percent of CFOs were expressing such a view.

U.S. Construction Industry’s Recovery Remains in Place

On top of economic uncertainties are political ones. In prior years, expressions of confidence have been most apparent early in the calendar year. But with CFOs, among others, increasingly fixated on presidential election year drama, confidence may be somewhat more suppressed earlier in the year than has been the custom. Time will tell.

With the collapse in commodity prices worldwide, construction input price inflation has not been a significant concern in recent surveys. That would change. Were materials prices to rise unexpectedly going forward, this would add to other potential cost pressures. For now, however, the U.S. construction industry’s recovery remains in place—contractors are getting busier, some are turning away work for the first time in years, and margins appear to be stable or better despite accelerating compensation costs.
A SIMPLE EXPLANATION OF CONFINDEX™

• The Overall CONFINDEX™ Number
  • Composite Index Comprised of 4 Sub Indices
    1) Business Conditions
    2) Financial Conditions
    3) Current Conditions
    4) 2016 Outlook – look ahead to December 2016

• Measurements Taken Using 8 Questions
  • Current Business Conditions
  • Future (1 year) Business Conditions
  • Current Bank Credit Availability
  • Future (1 year) Bank Credit Availability
  • Future (1 year) Bonding Credit Availability
  • Line of Credit Status
  • Current Backlog
  • Future (1 year) Backlog

• We calculate indices by taking the "net" of positive responses minus negative responses and adding 100. (Neutral and No Answers are excluded)

• Any index greater than 100 reflects more positives than negatives. Any index less than 100 reflects more negatives than positives.