CONSTRUCTION CFO CONFIDENCE FAILS TO FULLY REBOUND

Once Burned, Twice Shy

In recent years, the nation’s leading construction CFOs have approached each New Year with surging confidence only to be disappointed as certain years began in lackluster fashion. Chastened by repeated episodes of disappointment, CFOs are not approaching 2014 with a surging sense of confidence.

In the latest CONFINDEX survey conducted by the Construction Financial Management Association (Q4:2013), the Year Ahead Outlook Index declined for a third consecutive quarter to a reading of 132. While that reading is up 11.9 percent from the year-ago level, it is down from the reading of 139 registered during the March 2013 survey. The reading in December 2012 was heavily influenced by then existing fears of a dive off the nation’s fiscal cliff. When that dive failed to take place, CFO confidence surged in early 2013, heavily influenced by then existing fears of a dive off the nation’s fiscal cliff. When that dive failed to take place, CFO confidence surged in early 2013, but it has been slipping ever since.

At first glance, the steady erosion in CFO confidence seems at odds with emerging economic realities. Recent data regarding gross domestic product, employment and unemployment have been surprisingly good. With the housing market continuing to rebound, with auto sales remaining robust, and with share prices booming, economists have been racing to upgrade their respective economic forecasts for both the nation and the world.

The lack of improvement in the Year Ahead Outlook Index even seems inconsistent with certain other CONFINDEX survey findings. For instance, the business conditions index expanded from 142 to 147 during the fourth quarter, an improvement of 3.5 percent. On a year-over-year basis, the Business Conditions Index is up nearly 20 percent. Similarly, the Current Confidence Index expanded 2.5 percent during the quarter to a reading of 123, nearly 12 percent higher than the year-ago level.

An analysis of non-indexed survey readings raises even more questions regarding the unenthusiastic one-year outlook. For instance, construction CFOs appear increasingly confident regarding demand for construction. In the September 2013 CONFINDEX survey, only 10 percent of participating CFOs report being “not concerned at all” regarding the level of demand. By December, this proportion had nearly doubled to 18 percent. By contrast, the group characterizing themselves as “very concerned” declined in proportion from 17 percent to 15 percent.

It is only when one digs deeper into CONFINDEX readings that one begins to appreciate the reasons behind the lingering sense of unease collectively expressed by CFOs. First, the availability of financing for projects appears to have dimmed. The Financial Conditions Index declined during the fourth quarter of 2013 from a reading of 114 to 111. This represented the second consecutive quarter during which the Financial Conditions Index deteriorated.

The lack of improvement in credit availability for projects may have been due to elevated uncertainty regarding Federal Reserve policy regarding both its bond purchase programs and its stance on short-term interest rates. The Federal Reserve recently offered some clarity regarding these issues, which may create greater certainty among banks and other lenders going forward regarding their cost of funds. This in turn may lead to improving financial conditions during the months ahead.

CFOs also continue to express a high degree of skepticism regarding profit margin expansion despite the fact that materials prices remain generally well behaved. This appears to be closely tied to and partially explained by ongoing concerns regarding skills shortages. The proportion of CFOs that are highly concerned by skills shortages rose from 15 percent to 23 percent during the third quarter. Nearly two-thirds of CFOs (65%) are now either very or highly concerned, up from 60 percent one quarter ago.

With demand for construction services on the rise, the presumption among many CFOs is that long-discussed prospective skills shortages will increasingly be realized. This will lead to greater wage inflation, which in turn will hammer away at profitability even in the context of expanding revenues. Many CFOs continue to point out that construction is attracting relatively small numbers of labor force entrants, implying that the skills shortages will only worsen as more workers retire and as the industry continues to approach complete recovery.

But the most substantial source of concern regarding the path of profit margins appears connected to public policy. The proportion of CFOs that stated that they are not concerned at all about public policies regarding construction declined from 21 percent during the September 2013 survey to just 7 percent. Meanwhile, the share of respondents who are very or highly concerned rose from 23 percent in September to 31 percent in December.

Comments made by CFOs indicate that the primary focus of these policy-oriented concerns revolves around the ongoing implementation of healthcare reform and anticipated impacts of the Affordable Care Act on healthcare costs. Rising healthcare costs would of course squeeze profits margins.

Looking Ahead

Time will tell whether confidence readings will improve during the quarters ahead. Fourth quarter CONFINDEX respondents would not have been aware of recent progress made on the federal budget. Perhaps as a result, public policy-related concerns may become a bit less intense during the first quarter survey, which all things being equal would lead to higher confidence readings. However, healthcare cost-related concerns could intensify further, leading confidence in a different direction.
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) 2014 Outlook – look ahead to March 2014

• 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.