DEMAND IS AN ISSUE, BUT NOT THE PRIMARY ONE

There is also growing concern regarding the availability of financing for projects, which would also impact demand. The notion among a growing number of construction financial professionals is that banks are increasingly concerned by the potential formation of real estate bubbles. This is true in both multifamily and nonresidential categories, including hotels and retail space. During the first quarter, 27 percent of respondents indicated that they were unconcerned by the availability of financing. During the second quarter, this proportion fell to 24 percent, suggesting that a growing fraction of CFOs now have at least some concern regarding the availability of financing. Some CFOs also expressed concern regarding future interest rate increases to eventually be promulgated by the U.S. Federal Reserve.

The biggest source of concern continues to be skills shortages. During the first quarter, 71 percent of respondents were either very or highly concerned by emerging construction skills shortages. One quarter later and that proportion is up to 74 percent.

The shortage of skilled personnel can have many potential impacts, including quality of work, liability, timeliness of delivery, and client satisfaction. Shortages of any item also tend to bolster price and costs and, therefore, impact profit margins. Not surprisingly, only 1 percent of respondents expect profit margins to be significantly better one year from now.

Sub-Indices Also Reflect Growing Stress

Most sub-indices slipped during the second quarter. The Business Conditions Index declined 2.7 percent, falling from 148 to 144 during the quarter and also down 3.4 percent from a year ago. The Financial Conditions Index declined 4.7 percent on a quarterly basis (from 127 to 121), but is still up 7.1 percent from a year ago. The Current Confidence Index fell 2.9 percent during the quarter (from 139 to 135), but is up 8.9 percent from a year ago.

Perhaps most significantly, the Year-Ahead Outlook Index fell 4.5 percent from last quarter and is down by nearly 7 percent on a year-over-year basis (from 136 to 127). This represents the largest year-over-year decline in any of the indices. It is apparent that a combination of growing concerns regarding demand and expanding skills shortages have rendered CFOs a bit more nervous about profitability and business execution.

Another possible source of profit suppression is materials prices. No respondent indicated that materials prices will fall over the next year, indicating that CFOs believe that the recent episode of deflation in input costs is effectively over. Exactly half of the respondents expect input costs to rise over the next year, though the rate of increase in not expected to be substantial.

In Summary

The second quarter CFMA CONFINDEX Survey stands for the proposition that the construction recovery is set to continue, but the pace of recovery won’t be quite as brisk as many had anticipated from a first quarter perspective. Public policy and availability of financing have become more worrisome. Human capital and input costs are likely to rise. That said, 92 percent of CFOs expect profit margins to either be better or the same one year from now, indicating most contractors will be able to generate enough pricing power to fully offset, or more than fully offset, rising cost pressures.

Construction firms around the nation are generally busier. Nonresidential construction value put-in-place is up nearly 9 percent on a year-over-year basis. Construction employment is up by 4.5 percent over the past year and the construction worker unemployment rate is now below 7 percent.

Despite evidence of vigorous demand for construction services, CFOs did not express rising confidence during the second quarter of 2015. The Construction Financial Management Association (CFMA) conducts its CONFINDEX Survey each quarter. The Survey has emerged as one of the construction industry’s leading barometers of current and prospective business conditions with respect to sales, profitability, labor availability, and input costs.

During the most recent CONFINDEX administration, the Overall Index declined 4.4 percent from the prior quarter (from 137 to 131), but is up 1.6 percent from a year ago. The temptation is to attribute this sagging confidence on weak macroeconomic data. The U.S. economy shrank 0.7 percent on an annualized basis during the year’s initial quarter. Retail sales disappointed for several consecutive months, beginning with last November, and the March employment report was shockingly weak.

Demand is not the primary issue, however. True, in the first quarter Survey, 27 percent of respondents indicated no concern regarding demand for construction. One quarter later and that proportion has slipped to 21 percent, indicating that the level of concern regarding demand increased. Seventy-one percent of respondents are now watching demand with some level of concern, up from 65 percent during the first quarter.

Part of the concern regarding demand relates to public policy. The nation continues to have difficulty committing to long-term infrastructure funding. Nowhere is this more apparent than with respect to the Highway Trust Fund, which was recently extended for two months. Correspondingly, during the first quarter, 30 percent of respondents expressed no concern regarding the impact of public policy on construction. One quarter later that proportion fell to 21 percent. By contrast, 39 percent of respondents are now highly concerned regarding the impact of public policy on construction, up significantly from 32 percent during the first quarter’s Survey administration.

There is also growing concern regarding the availability of financing for projects, which would also impact demand. The notion among a growing number of construction financial professionals is that banks are increasingly concerned by the potential formation of real estate bubbles. This is true in both multifamily and nonresidential categories, including hotels and retail space. During the first quarter, 27 percent of respondents indicated that they were unconcerned by the availability of financing. During the second quarter, this proportion fell to 24 percent, suggesting that a growing fraction of CFOs now have at least some concern regarding the availability of financing. Some CFOs also expressed concern regarding future interest rate increases to eventually be promulgated by the U.S. Federal Reserve.

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Sub-Indices Also Reflect Growing Stress

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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 June 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.