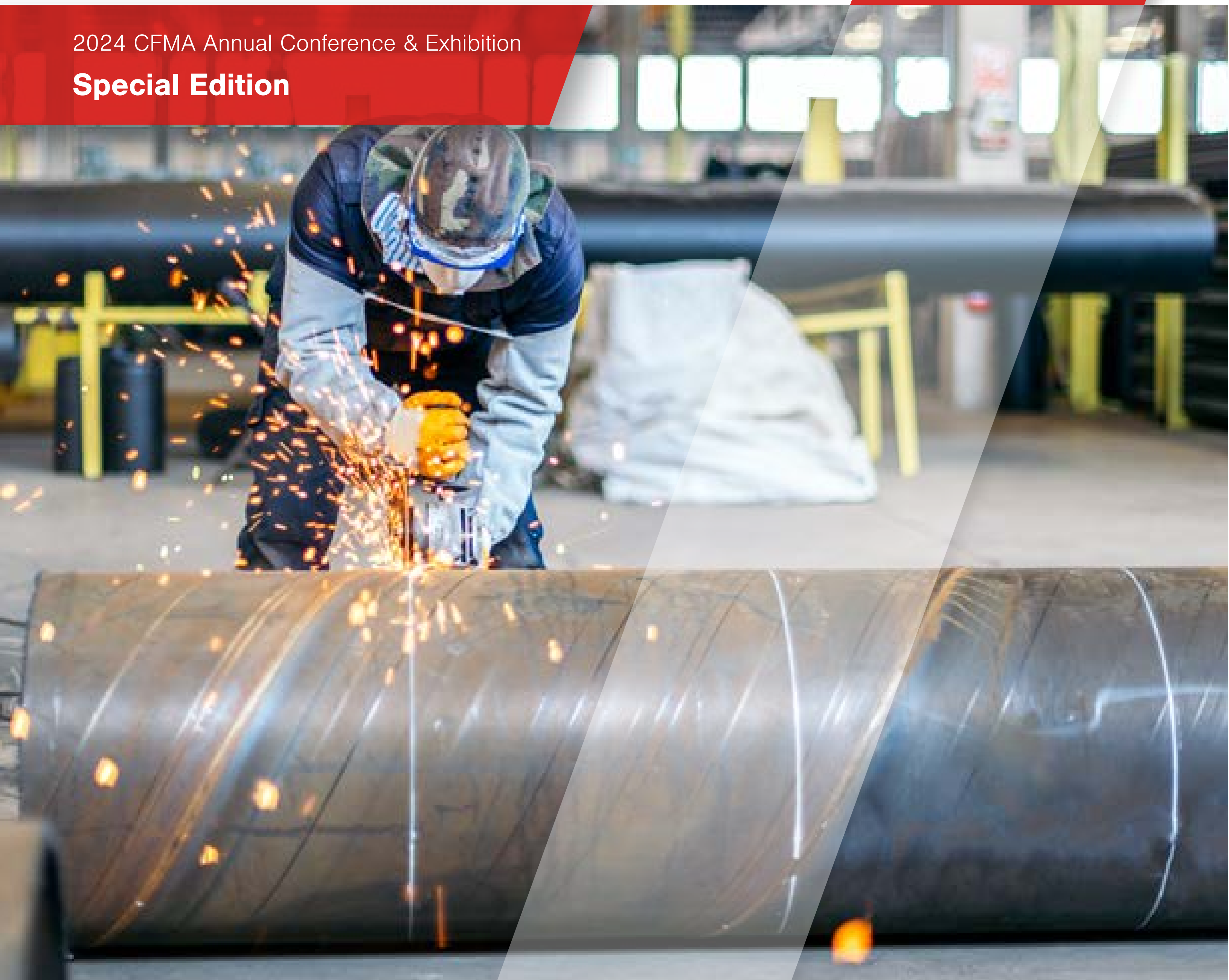
2024 CFMA Annual Conference & Exhibition

Special Edition



Construction Quarterly by FORVIS

Construction Leaders Are Optimistic—We're Not So Sure

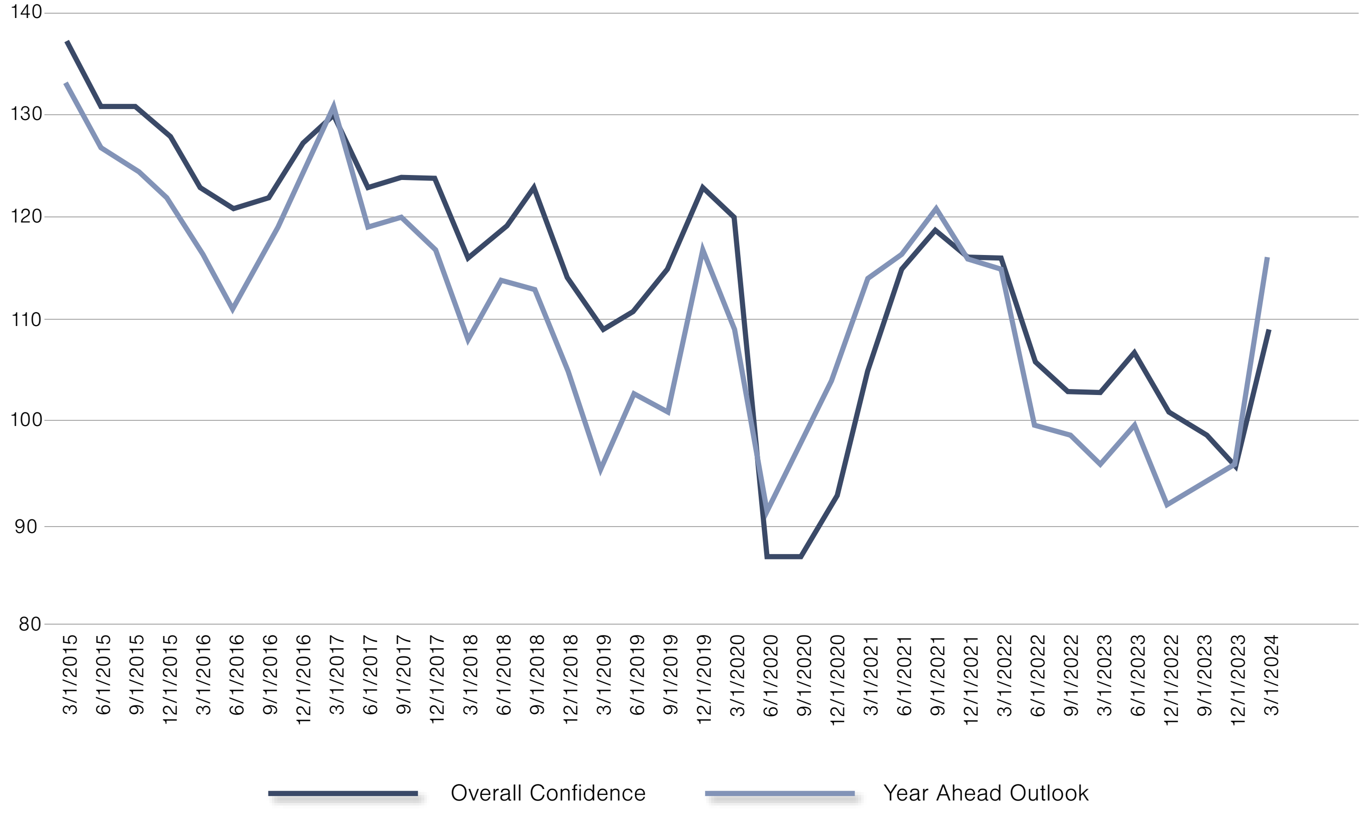
May 2024

Construction leaders are optimistic about the year ahead. Industry confidence had been on a downward trend since midway through 2021, but this quarter, construction CEOs, CFOs, and other leaders changed their tunes. What happened within the industry and across the nation that made their viewpoints so bright?

Construction Confidence Has Risen—But Why?

Each quarter, the Construction Financial Management Association (CFMA) through its CONFINDEX survey, polls construction CFOs, CEOs, and other sector leaders to measure their level of confidence in the industry. The March 2024 report[1] shows that overall confidence has rebounded after more than two years of falling confidence ratings. Industry leaders are now more optimistic than not.

March 2024 CONFINDEX Survey Results



>100 is a viewpoint that's better than worse
<100 is a viewpoint that's worse than better

1 "Confidence Surges to Begin New Year," cfma.org, March 2024.

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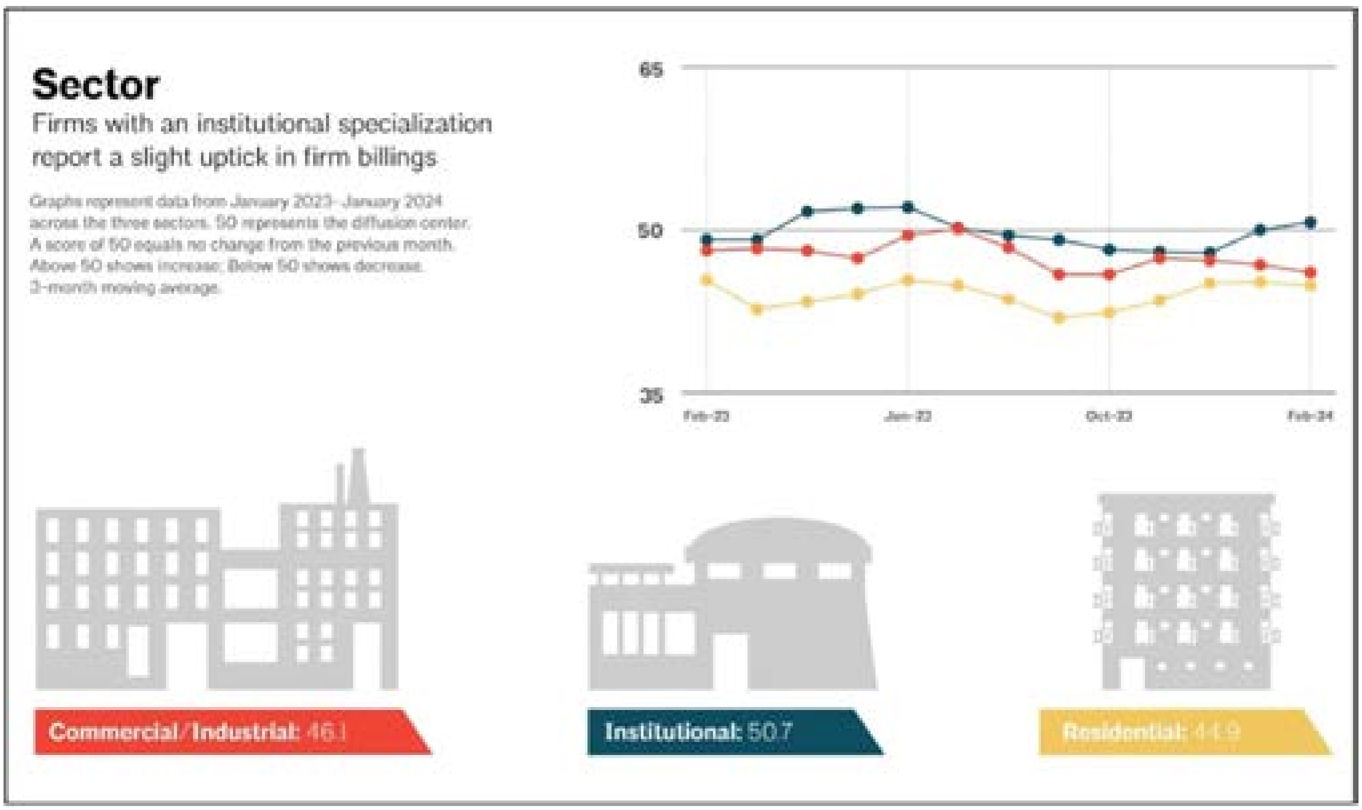
When talking to our clients, we hear that their boost in confidence is for some of the following reasons:

- Contracts that were postponed for years are now ready to launch.
- Backlog continues to be strong.
- Materials prices have stabilized.
- Infrastructure, manufacturing, and other government-led projects are abundant.
- Supply chains are more reliable, and they've built proven contingency plans to manage delays that do occur.

We see it from our perspective, too. 2023 felt like a productive year for our clients, and in 2024, we know that many will finally be pushing some high-dollar projects from the planning phase into the production phase. However, we are a bit skeptical that the future will be as bright as contractors predict. While we think that there are plenty of good things coming in the next 12 months, we want to note some potential roadblocks.

ABI is still falling.

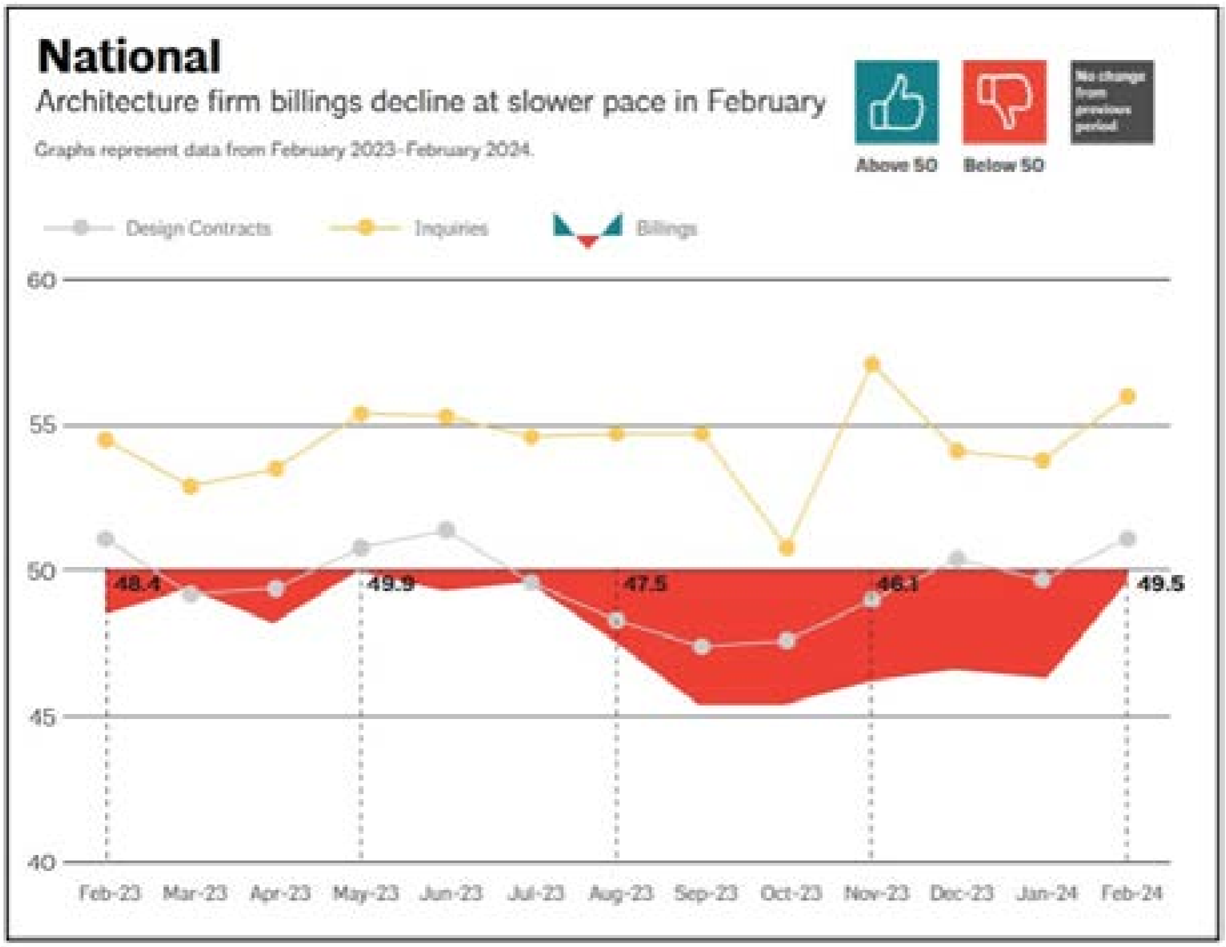
The architecture billings index (ABI) has been declining for 13 consecutive months. Although the decline appears to be slowing, February closed with continued weakening billings. When broken out by sector, we see that residential and commercial billings are down, but industrial billings are seeing a slight uptick—but just barely.



Source: "ABI February 2024: Pace of Billings Decline Continues to Slow," aia.org, March 20, 2024.

We like to take ABI into consideration when strategizing with our clients because it's such a great indicator of construction industry performance. Changes in architecture billings often precede economic changes for contractors by 9 to 12 months. From the ABI reports, we see that:

1. **Architecture billings are still down.**
   National ABI scores jumped from 46.2 in January to 49.5 in February. Because a score of < 50 indicates that more architecture firms are reporting decreases in billings than are reporting increases, we can see that they're still falling overall—just at a slightly slower rate than last month.



Source: "ABI February 2024: Pace of Billings Decline Continues to Slow," aia.org, March 20, 2024.

2. **Inquiries into new projects are growing.**
   National ABI scores jumped from 46.2 The February 2024 report shows that inquiries into new projects grew at their fastest pace since November. Although inquiries are growing, a billings score of < 50 indicates that it may be some time before those inquiries are converted into contracts.

Both data points could indicate an upswing in the demand for new projects, but at best, we wouldn't see results until 2025. We will watch how ABI changes in the coming months to see if this upward trend continues.

The outcome of the election could throw a wrench in even the best-laid plans.

The inability to predict the outcome of the impending presidential election is making some of our clients a bit nervous.

The current administration has approved a seemingly unchecked expansion of large-scale infrastructure projects, and contractors who have shifted their project mix more heavily toward these types of contracts may find it difficult to find similar successes if government leaders change. In the CONFINDEX survey, survey respondents had some of the following things to say about this year's election:

- "A lot of cash for commercial projects [is] on the sidelines waiting out higher interest rates and the election."
- "[It's an] election year—anything can happen."
- "The election is at the forefront of everyone's minds. What will a Biden/Trump re-election look like?"

Public policy makes future successes tenuous.

We are seeing that tax policy and regulations matter, both at the federal and local levels. Public policy has a significant impact on the construction industry because policy changes could alter:

- The expansion and availability of public projects
- Union contracts
- Tariffs and other restrictions on imported materials
- Prevailing wages and other labor expectations
- Interest rates
- Taxes

This last point is a big one for our clients, especially right now.

> "Legislative changes and evolving case law are currently having a significant impact on tax benefits recognized by contractors for research and development activities."
>
> -- Heather Alley, CPA, tax partner at FORVIS

Let's dig deeper into R&D to see what she means.

How Public Policy Has Impacted R&D

Research and development (R&D) costs are broadly defined by Section 174 of the tax code, and many expenses incurred by construction business would qualify. For example, if a construction business implemented new software that improved their resource allocation process, those costs could be classified as §174 R&D expenditures. Unfortunately, thanks to a policy change enacted in 2017, domestic R&D expenditures can no longer be expensed the year they were incurred; instead, those deductions must be spread out five years.

When this tax law change first went into effect, companies were tempted to classify their R&D expenses as something else in order to take the full deduction. If, for example, those R&D expenses were considered general operational costs rather than R&D expenditures, they would be fully deductible. However, companies that went this route ended up hurting themselves in a different way. By not classifying R&D expenses accurately, they made themselves ineligible for the R&D credit.

Lawmakers are currently working to get a bill pushed through Congress that amends §174. As of April 4, 2024, this bill has passed the House and is waiting to be heard in the Senate. If this bill makes its way through, businesses will once again be able to immediately deduct domestic R&D expenses rather than amortize those costs over five years. If businesses are less hesitant to classify expenses as R&D, they may also be eligible for a larger R&D tax credit.

With one simple tax law change in 2017, Congress changed how businesses thought about R&D expenses. If the tax law changes again in 2024, R&D could have a much different impact on contractors' bottom lines than originally anticipated.

This illustration shows just how disruptive one simple tax law change can be for businesses. If the deductions or credits that businesses build into their projections are taken away or altered in some way, their projects may become less (or more) profitable nearly overnight.

Janeen Butler, CPA, CCIFP, tax senior manager at FORVIS, recognizes that policy changes, especially at the local level, are not meant to negatively impact the construction industry. She said,

> "Construction and real estate is a part of every community, big or small, so lawmakers generally have an interest to make sure it is thriving ... But they don't always get it quite right."
>
> -- Janeen Butler, CPA, CCIFP, tax senior manager at FORVIS

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Even with uncertainty in the air, there are things you can do to come out on top.

Contractors who are successful are those who consider all types of market uncertainties when drafting their proposals. Alley says that "successful contractors consider items that extend beyond just those called for directly in the plans and specifications, like local ordinances, environmental factors, and the labor market."

Success stories don't have to be few and far between, either. There are many ways that construction businesses can thrive in an uncertain market.

1. **Manage your backlog effectively.**
   Backlog is typically seen as a good thing, but it can be a hindrance if you're not careful.
2. **Fine-tune your operations.**
   Even if you cannot control the market, you can improve your operations. Doing so will help ensure those market fluctuations have less of an impact.
3. **Consider implementing technology in your back office.**
   Your back office could see significant efficiency gains if you implement new and developing technologies.
4. **Harness the power of AI on the jobsite.**
   Artificial intelligence for use on the jobsite is more accessible than you realize, and introducing just a few small changes could put you one or two steps ahead of the competition.

Contractors who navigate these issues effectively will be those who understand the evolving requirements of the industry, and whose plans consider and mitigate the negative effects of environmental and political uncertainties.

CFMA Annual Conference & Exhibition

Join construction finance industry professionals at CFMA's Annual Conference & Exhibition on May 18–22 in Grapevine, Texas. Get ready for mini-conferences, general sessions, breakout sessions, construction technology forums, roundtable discussions, networking opportunities, and much more! FORVIS is a proud Principal Partner of CFMA and this premier industry event, and we hope to see you there—stop by booth 727 to connect with our construction team.

Be sure to join Sarah Windham, an assistant managing partner from FORVIS, during **Tax Mini-Conferences** on Sunday, May 19:

- Part 1: 1–2 p.m. CT
- Part 2: 2:15–3:30 p.m. CT
- Part 3: 3:45–5 p.m. CT

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Also, catch Dan Gaston, partner and construction subniche leader, during the **Emerging Issues in Accounting & Finance** session on Sunday, May 19 from 11–11:50 a.m.

For more information and construction industry insights, visit forvis.com/construction.

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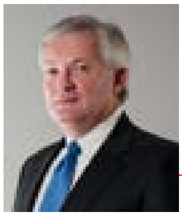

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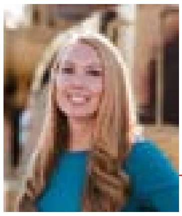

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For more information and construction industry insight, visit **forvis.com/construction**.