# Construction Quarterly

## The Future Is Uncertain, But Here's What We Know

July 2024

**Industry confidence was unexpectedly high last quarter. For the first time since mid-2022, construction CEOs, CFOs, and other industry leaders conveyed they were confident about the year ahead. But, as we discussed in our report from last quarter, we were a bit skeptical this confidence would last. While there were—and are—reasons to be positive, we knew there were roadblocks that could prove to be a hindrance to both short- and long-term success.**

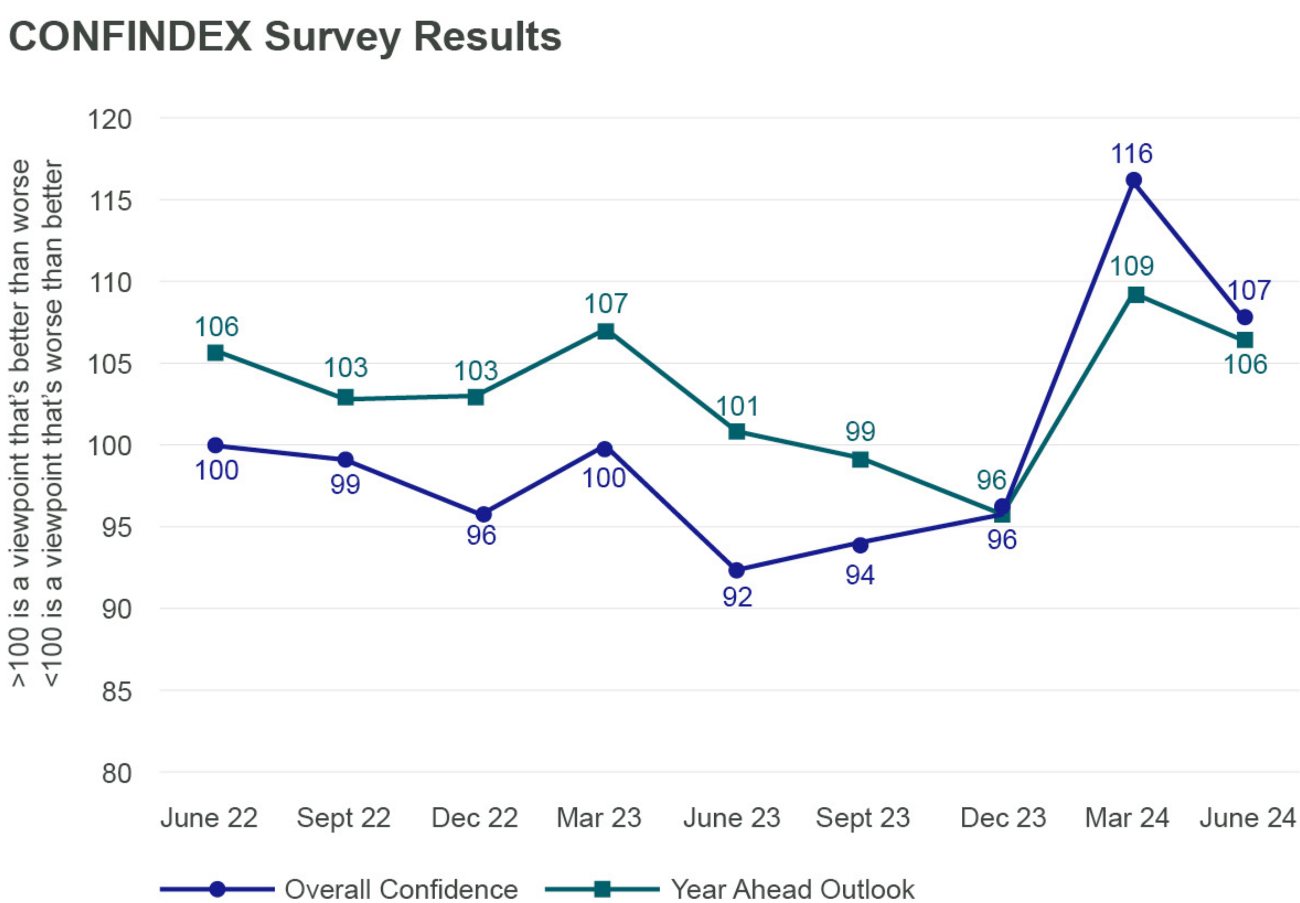
## Industry Uncertainty Lowers Confidence

The quarterly CONFINDEX report[1] from the Construction Financial Management Association (CFMA) polls construction leaders to measure their level of confidence in the industry. This quarter's report is still positive, although confidence dropped back down to a level we believe represents true industry sentiment. It shows construction leaders are feeling positive about the year ahead, but only slightly more confident than they felt at the end of last year.

We attribute this drop in confidence to one thing:

Uncertainty.

Across nearly all niches in the industry, our clients have shared they are uncertain about the trajectory of the construction market.




1 "Second Quarter Confidence Slumps," cfma.org, June 2024.

"As I talk to contractors regarding their confidence in the economy, the response varies dependent upon the market they work in and their respective area of construction," says Sarah Windham, a construction tax partner at Forvis Mazars. "For example, many contractors in the Southeast, especially near the coast, have more confidence in the future than those in other areas of the country due to demand."

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**Sarah Windham**
Partner

The CONFINDEX survey results seem to agree. Here are some comments from the CFMA survey we found noteworthy:

- "Interest rates seem to be a guessing game." We expect interest rates to fall but don't know exactly when. Until they do, you may see your clients take a step back on new construction. Your backlog might hold you for now, but what will that backlog look like in six months or even a year from now? Will those projects be the ones you want, at a price point you want?
- "Depending on who is in power, public policy can change on a whim." The political landscape is precarious right now, which means fiscal and environmental policies could change quickly. While economists can make educated guesses about what the future holds, we won't know anything for certain until the next leader's cabinet outlines its goals and legislators draft new policies.
- "The smaller guys are pushed away to allow bigger fish to eat." Large-scale projects have been the name of the game since 2020. In fact, in April 2024, the Department of Labor announced 16 new, large infrastructure projects under the Biden-Harris administration's Mega Construction Project Program. Mega projects like these offer incentives that draw major players from across the country, robbing smaller contractors of the chance to claim jobs in their own territories, along with consuming the local workforce.

With all this uncertainty in the market, what can contractors do to help enable future success?

## Control What You Know

There is usually something you can do to improve your position. From our viewpoint, the following three topics are areas that you can address now. Doing so will help put you in a better position to thrive, regardless of what happens in the future.

### Sustainability Policies

Sustainability policies have become increasingly important in construction and real estate. In fact, the SEC now mandates that public companies disclose climate-related information in their periodic reports. These policies are sometimes interchangeably referred to as environmental, social, and governance (ESG), corporate social responsibility, or environmental compliance, and the core of these policies revolves around risk management, process improvement, and safeguarding shareholder value.

When reviewing your own sustainability policies, keep the following top of mind:

- Physical climate risk: Rising sea levels, flash floods, storm surges, and drought are more common than ever. How are you managing these risks? Your policy should consider where and how you're storing building materials, how complex your supply chain is, where your suppliers are located, etc.
- Greenhouse gas emissions (GHGs): Think about GHGs from multiple angles in the construction process, from how you source materials to the types of materials and the energy you use.
- Transition risk: There will be growing pains as you navigate the impending transition to a lower-carbon economy. If you build transition risk into your sustainability policy, you may:
  - Consider new and beneficial technologies sooner than you would have otherwise.
  - Track and adjust to changing market demands.
  - Pay closer attention to policy trends, which will help you stay ahead of compliance changes.
- Supplier and customer compliance: Not only will you consider your own social impacts, but you'll also need to consider the sustainability policies of your suppliers and customers. Are those companies showing the same level of social responsibility you are? Many customers and suppliers are requiring their downstream partners within the value chain to show progress in the areas of sustainability and corporate social responsibility.
- Sustainability policy and your exit strategies: Your sustainability policies may play an important role in your exit strategy. Corporate social responsibility (or lack thereof) can bring in (or turn away) buyers and can even impact valuation when you're ready to sell.

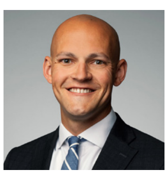
Even if you aren't required to disclose sustainability and corporate social responsibility policies in your financial statements, SEC mandates may trickle down to the private sector. Nate White, director of the Enterprise Risk & Quantitative Consulting team at Forvis Mazars, says that private-company stakeholders are already demanding more transparency.

"Regardless of the size of your entity, your stakeholders—maybe it's an investor, a bank, a founder, or an employee—expect you to establish a sustainability policy. Stakeholders want to know what you're doing for the environment and how you're positively impacting the community," he says. "High performance in the area of sustainability can drive business success and influence investor decisions, supplier compliance, and regulatory compliance. For our clients, integrating sustainability principles means unlocking growth opportunities, mitigating risks, and aligning strategies with evolving societal expectations."

If you're not proud to share your sustainability policies, it's time to change them.

Fortunately, you don't need to overhaul your policies overnight. White suggests you first gain a baseline understanding of what sustainability is to your company, understand your risks, and then address your shortcomings in chunks.

> "Think about where you want to start and make a plan for progress."



**Nate White**
Director of Enterprise Risk & Quantitative Consulting

## State Regulatory Requirements

Closely related to the sustainability discussion are the regulatory requirements from state and local governments. While many states have proposed implementing stricter environmental standards, California has actually taken action. Two of these requirements are:

- Senate Bill (SB) 253, Climate Corporate Data Accountability Act: Companies doing business in the state of California with revenues over $1 billion must report on greenhouse gas emissions and obtain third-party assurance on those reports.
- SB 261, Climate-Related Financial Risk: Large corporations doing business in California must publicly disclose climate-related financial risks and the measures they're taking to mitigate those risks.

State-specific regulation like this can be challenging, first because businesses need to be aware they exist. Being tapped into the regulatory landscapes of multiple jurisdictions can be burdensome. Once you know they exist, it may help to then:

- Understand them
- Determine if they apply to you
- Measure your environmental impact
- Make changes so that you come into compliance

These types of environmental regulations may require you to overhaul your operations. Complying with SB 253, for example, could require you to tweak nearly every aspect of the construction process to effectively track carbon emissions within your operations. To comply with California standards, you'll need to consider:

- How you source materials
- What materials you use
- How much water you use during construction
- What types of vehicles and machinery you use
- How you recycle or repurpose leftover materials
- What you disclose to the public
- How you prove and report on environmental compliance

Environmental regulation is an evolving field. We fully expect states to target industries that have historically been high emitters of emissions, such as construction and real estate. Be prepared for added scrutiny.

## Prevailing Wage

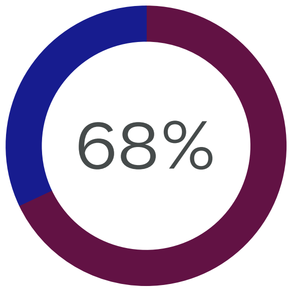
The Inflation Reduction Act (IRA) became one of the nation's largest investments in clean energy and climate security when President Biden signed it into law in August 2022. A major proponent of the IRA is that it boosts energy credits for contractors who pay their workers a predetermined "prevailing wage" on certain government-funded projects.

Unfortunately, the prevailing wage requirement has become a bit of a sticking point for some of our clients. In some jurisdictions, the prevailing wage is outpacing the going rate for skilled labor. Contractors need to determine if paying higher wages is worth the benefit.

In other words, will the boosted tax credits be more than the additional labor costs?

Still, construction colleagues need to calculate more than just a dollar-for-dollar comparison; they also need to consider cash flow. Prevailing wage tax credits may be awarded months after you pay those salaries. If your cash flow can't carry you, you may be better off not applying at all.

At any rate, we know profit margins are tight.




of CFMA survey respondents said that they predict profit margins will be the same or worse a year from now.

Energy tax credits could help boost profit margins, but it's a determination you'll need to make with your tax advisors.

## Uncertainty Is Not an End All, Be All

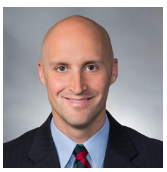
Let's leave you with a quote from the CONFINDEX survey:

> "Who knows what is lurking out there."

Uncertainty is the one true constant right now. In light of this, focusing on what you know to be true and refining operations where possible can help you prepare to handle whatever comes your way.

For more information, please contact one of our contributors, or visit our Construction Services for additional construction resources. Also, you can access our Construction Quarterly by Forvis Mazars archives here for more valuable insights.

# Contributors

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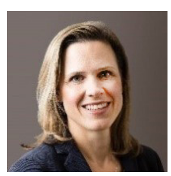

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For more information and construction industry insight, visit forvismazars.us/construction.