



LEADING INDICATORS MOSTLY POINT DOWNWARD

This article looks to many of the top construction indicators for information on what may lie ahead for the industry.

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Coming into 2020, a variety of leading economic indicators pointed skyward, indicating that the strong market for those who supply construction services would continue indefinitely. The Marcum Commercial Construction Index, which tracks a variety of the fundamental construction indicators, showed an industry with rapid job creation and record-high nonresidential spending. With the overall labor market continuing to create plentiful jobs, consumers spending with conviction, financial markets surging, state and local government finances healthy, and interest rates remaining unusually low, opportunities for contractors spread from sea to shining sea during the run-up to the current year.

Many contractors showed record sales and profits in 2019 but still managed to complain about stresses associated with too much work and too few workers. Leading

indicators suggested that 2020 would be even better. Then came COVID-19 and the world turned upside down.


Leading indicator #1: American Institute of Architects' Architecture Billings Index

Before construction, there is design, permits, fees, financing, rezoning, etc. The Architecture Billings Index (ABI) monitors the level of billing activity among architectural firms.¹ The index is based on the American Institute of Architects' Work-on-the-Boards survey and has historically registered a lead time of around 9 to 12 months with respect to relevant construction activity.

An ABI score above 50 indicates that more firms reported an increase in architectural billings than reported a decrease. An ABI score of 100 would signify that all respondents reported an increase in billings. Any score below 50 indicates an overall decline in billings, which signals an eventual decline in nonresidential construction spending. In July 2020, the most recent month for which these data are available,

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the ABI stood at a lowly 40.² This is the fourth consecutive month during which the ABI has fallen short of the threshold reading of 50.

Given tighter project financing conditions, woeful state and local government finances, a shrunken economy, elevated commercial vacancy, uncertainty associated with impending elections, and a healthy dose of dread, the fact that the pace of design work has softened comes as little surprise. Still, negative readings on leading indicators are seldom pleasant. If past trends hold, many contractors will find 2021 to be a challenging year, especially those that are already aggressively working through their remaining backlog.

Leading indicator #2: Associated Builders and Contractors' Construction Backlog Indicator

Each month, Associated Builders and Contractors (ABC) compiles its Construction Backlog Indicator (CBI), a forward-looking national economic indicator that reflects the amount of work that will be performed by commercial and industrial contractors during the months ahead.³ Over the course of many years, several contractors experienced a rising backlog, an indication that they could expect to remain fully engaged for the foreseeable future.

Indeed, that accumulated backlog proved invaluable during the early months of the pandemic when much of the balance of the economy was shut down, but construction activity largely persisted due to the industry's general status as "essential" and the fact that a significant volume of project work was already underway. But those pesky leading indicators, including the CBI, point to more challenges ahead.

In July 2020, ABC's CBI slipped to 7.8 months, a drop of 0.3 months from June 2020 and a full month below the same time last year.⁴ This represents a stark departure from the end of 2019 as well as the early months of 2020 when the backlog hovered around 9 months. The western United States have been hit hardest in terms of lost backlog, indicating a disproportionate share of project cancellations. While CBI bounced back modestly in August 2020, the backlog remains well below its year-ago level. ABC's

Construction Confidence Index (CCI) also points to more challenges ahead, with the average firm expecting smaller profit margins over the next six months.

Leading indicator #3: The USG/U.S. Chamber of Commerce Commercial Construction Index

The Commercial Construction Index is yet another construction industry leading indicator foreshadowing the industry's direction. The index is compiled by the USG Corporation and the U.S. Chamber of Commerce.⁵ It measures three key metrics:

1. backlog;
2. new business opportunities; and
3. revenue projections.

The index is intended to gauge how contractors feel about the current state of the industry.

Like other leading indicators, the latest readings indicate contraction in construction activity. During 2020's first quarter, when COVID-19's impact was largely limited to the final weeks of March, the CCI stood at 74, one of the highest readings in history.⁶ By the second quarter, however, the reading had slipped to 56, with only 16 percent of contractors indicating that they had high confidence in business opportunities over the next 12 months.⁷ That was down from 54 percent just one quarter earlier.

Leading indicator #4: Construction Financial Management Association's Confindex

The Construction Financial Management Association produces the Confindex Indicator based on a quarterly survey of members.⁸ Confindex readings recently declined to multiyear lows. The overall Confindex reading declined from 120 during 2020's initial quarter to 87 by the second, a drop exceeding 27 percent.⁹ Confindex is down nearly 22 percent from a year ago and is only up 10 percent from its global financial crisis impacted reading of 79, registered in December 2008. As a reflection of how unnerved certain financiers have become, the Financial Conditions Sub-Index slipped from a first quarter reading of 123 to 99 during the second, a decline approaching 20 percent.

Looking ahead

With respect to America's construction economy in 2020, the readings supplied by a variety of leading indicators coming into the year proved to be overly optimistic. These readings are not gospel. On the other hand, seldom is there such alignment between the collection of leading indicators, with each of them presently flashing yellow or red with respect to the outlook for non-residential construction during the quarters ahead.

In January 2008, at the very start of the prior downturn, the ABI stood at 51.9. Beginning just one month later, the ABI would remain below the threshold reading of 50 for 33 consecutive months, correctly predicting that many contractors would not begin to experience stability until some point in 2011 (the ABI rose above 50 in November 2010).

The CBI was also prescient. Prior to the 2008 financial crisis, backlog hovered around seven months. After the bubble popped and the market collapsed, the CBI dropped sharply and continued falling until it bottomed out at 5.8 months in January 2010. Within two years, however, it reached 7.8 months, signaling better times ahead during the years to come.

Although one cannot therefore ignore leading indicators, there are events that can prove them fallible. One wildcard that could produce erroneous construction fore-

casts is public sector stimulus, including in the form of a sizable infrastructure package. Perhaps the upcoming elections will be the most important in American history after all. ■

NOTES

- ¹ "Architecture Billings Index," The American Institute of Architects. Available at: <https://www.aia.org/resources/10046-the-architecture-billings-index>.
- ² "ABI July 2020: Business conditions remain soft at architecture firms, as clients are reluctant to move ahead with new projects," The American Institute of Architects. Available at: <https://www.aia.org/pages/6320486-abi-july-2020-business-conditions-remain-s>.
- ³ "Construction Backlog Indicator," Associated Builders and Contractors. Available at: <http://www.abc.org/News-Media/News-Releases>.
- ⁴ "ABC's Construction Backlog Indicator down in July; contractor optimism falls," Associated Builders and Contractors (Aug 11, 2020). Available at: <http://www.abc.org/News-Media/News-Releases/entryid/18041/abc-s-construction-backlog-indicator-down-in-july-contractor-optimism-falls>.
- ⁵ "Commercial Construction Index," USG Corporation. Available at: <https://www.usg.com/content/usgcom/en/about-usg/commercial-construction-index.html>.
- ⁶ "USG + U.S. Chamber of Commerce Commercial Construction Index - 2020 Q1," U.S. Chamber of Commerce (March 31, 2020). Available at: <https://www.uschamber.com/report/usg-us-chamber-of-commerce-commercial-construction-index-2020-q1>.
- ⁷ "USG + U.S. Chamber of Commerce Commercial Construction Index - 2020 Q2," U.S. Chamber of Commerce (June 23, 2020). Available at: <https://www.uschamber.com/report/usg-us-chamber-of-commerce-commercial-construction-index-2020-q2>.
- ⁸ "CFMA CONFINDEX survey," Construction Financial Management Association. Available at: <https://www.cfma.org/news/content.cfm?ItemNumber=7598>.
- ⁹ "CONFINDEX quarterly reading," Construction Financial Management Association. Available at: <https://www.cfma.org/resources/content.cfm?ItemNumber=959>.