Nonresidential Construction Sector Flat in Fourth Quarter

By Anirban Basu, Chief Construction Economist at Marcum LLP

The combination of electoral uncertainty, fears of a fall off the fiscal cliff, a sharp decline in defense outlays and negative adjustments to inventory produced a shrinking U.S. economy during last year’s final quarter. Real gross domestic product decreased 0.1 percent at a seasonally adjusted annual rate in the fourth quarter, ending a growth streak for the U.S. economy that spanned 13 quarters. Overall annual economic growth tallied 2.2 percent in 2012, following a 1.8 percent annual increase in 2011.

While some of the negative pressures on the economy were temporary and there is little reason to believe that the economy is now in the midst of recession, the fact is that economic momentum slowed during the final months of 2012. With several tax rates rising as of January 1st, the expectation is that economic growth will remain unusually soft during the first half of 2013.

Viewed from a broader timeline perspective, there have been signs of progress. In 2012, the nation added 2,170,000 jobs, which translates into a monthly average approaching 181,000 jobs. The unemployment rate finally declined below 8 percent and as of this writing stands at 7.9 percent.

Financial markets also performed well. For the year, the NASDAQ was up 16 percent, the S&P 500 was up 13 percent and the Dow was up 7 percent. The housing market also made substantial progress, with both residential rental and owner-occupied segments recovering last year. Progress remains much slower in the nation’s nonresidential construction industry. By the end of the fourth quarter, nonresidential construction spending grew just slightly from an annual rate of $565.3 billion in September to $570.4 billion by December. December was soft with various nonresidential components reporting mixed results. Of the 16 subsectors that comprise nonresidential construction in the U.S., 6 reported construction spending reductions and 10 reported increases in December on a seasonally-adjusted basis. However, at least some of the growth is attributable to Hurricane Sandy rebuilding and therefore is not necessarily indicative of accelerating industry momentum.

In terms of nonresidential construction spending growth last year, top performers included lodging, up 16.1 percent; transportation, up 13.9 percent; power, up 11.2 percent; and commercial, up 9.1 percent. There is a story behind each of these segments. For instance, transportation-related construction rose this year because of a number of high-profile projects taking place around the country, including in New York, California and Northern Virginia. Consumer spending helped to support lodging and commercial construction. Demand for cheaper and cleaner energy continues to sustain momentum in power-related construction.

Overall construction spending was up 7.8 percent last year, with residential spending up more than 22 percent. However, nonresidential construction spending was up on the order of a bit more than 1 percent. Both residential and nonresidential construction employment expanded last year, led by 2.7 percent job growth in both the heavy and civil engineering and residential specialty trade contractor segments. Employment among nonresidential specialty trade contractors equaled 0.8 percent according to the Bureau of Labor Statistics.

The economy continues to face headwinds. Over the next few weeks or months, Congress will need to consider automatic sequestration, whether or not to extend the continuing budget resolution and an increase in the debt ceiling. Taxes have already risen, including payroll taxes that will serve to reduce disposable consumer income this year. Income, capital gains and dividend tax rates have also risen for some Americans.

All of this suggests that the initial half of 2013 will offer grinding progress at best. However, if the federal government is able to navigate key budget and tax issues, the latter half of the year could be much better. The performance of financial markets has helped to restore capital and a certain degree of confidence as reflected in rising Architectural Billings Index readings. America’s energy renaissance continues and low interest rates will continue to support sales of housing, autos and other consumer-related items. Of course, there are many things that could trip up the economy, including ongoing turmoil in Europe, the Middle East and in other global hotspots. There may also be more volatility in construction materials prices in 2013 after a relatively benign 2012.
With another quarter under our belts, as I approach the new year with my Construction clients, I’ve assumed a mindset of cautious optimism for our industry. While growth has been flat, as our survey shows, I’m seeing some key growth indicators come to life.

As I talk with my contractor clients, I’ve been very pleased to hear the long, recession-based winter on new work has begun to thaw out. Something, frankly, I’ve been dying to hear for a long while now. As we all know…all of our surveys, indices and opinions are just talk if the American construction contractor isn’t booking jobs. Even though bonding remains tight and profit margins haven’t risen to the sellers’ market levels we’d all like to see, I’m, again, cautiously optimistic that means growth in quarters to come. No doubt, as work begins to stack up and the workforce becomes more pressurized, the profit margins will increase to a more appropriate level.

Our business, the construction business, can be a tricky one to forecast – largely due to the industry-specific nature of the “backlog.” Backlogged business forestalls the immediate economic influences that so dramatically affect the rest of the world on both ends – for better and for worse. Compounding the “time warp” that this creates, backlogs are not something that can be drummed up over a weekend or with the stroke of a legislator’s pen. They take time, and they require a healthy economy in which to grow. All that being said, my clients are telling me and showing me backlogs that are growing, and while not yet robust, they are back on a track towards good health.

So, for the end of 2012 and the beginning of 2013, let’s go with So Far… So Far… So Good, and work to maintain an optimism that will, I hope in the near future, no longer need yellow tape around it.

Have a great Q1 2013.

Joseph Natarelli, CPA
National Construction Industry Group Leader at Marcum LLP

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### Fourth Quarter 2012 Performance

<table>
<thead>
<tr>
<th>Gross Domestic Product</th>
<th>Quarterly Values</th>
<th>% Change from</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012Q4</td>
<td>2012Q3</td>
</tr>
<tr>
<td>Overall Real GDP</td>
<td>-0.1%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Nonresidential Fixed Investment in Structures</td>
<td>-1.1%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Construction Spending, Seasonally Adjusted (in millions)</th>
<th>Dec-12</th>
<th>Nov-12</th>
<th>Dec-11</th>
<th>Nov-12</th>
<th>Dec-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Construction</td>
<td>884,980</td>
<td>876,942</td>
<td>820,614</td>
<td>0.9%</td>
<td>7.9%</td>
</tr>
<tr>
<td>Residential</td>
<td>314,567</td>
<td>308,233</td>
<td>257,142</td>
<td>2.1%</td>
<td>22.3%</td>
</tr>
<tr>
<td>Nonresidential</td>
<td>570,413</td>
<td>568,709</td>
<td>563,473</td>
<td>0.3%</td>
<td>1.2%</td>
</tr>
<tr>
<td>Lodging</td>
<td>11,620</td>
<td>11,410</td>
<td>10,009</td>
<td>1.8%</td>
<td>16.1%</td>
</tr>
<tr>
<td>Transportation</td>
<td>40,564</td>
<td>41,333</td>
<td>35,602</td>
<td>-1.9%</td>
<td>13.9%</td>
</tr>
<tr>
<td>Power</td>
<td>93,821</td>
<td>92,559</td>
<td>84,351</td>
<td>1.4%</td>
<td>11.2%</td>
</tr>
<tr>
<td>Office</td>
<td>38,337</td>
<td>37,597</td>
<td>35,135</td>
<td>2.0%</td>
<td>9.1%</td>
</tr>
<tr>
<td>Commercial</td>
<td>47,307</td>
<td>47,910</td>
<td>45,695</td>
<td>-1.3%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>50,679</td>
<td>49,457</td>
<td>51,031</td>
<td>2.5%</td>
<td>-0.7%</td>
</tr>
<tr>
<td>Health care</td>
<td>40,392</td>
<td>39,778</td>
<td>40,859</td>
<td>1.5%</td>
<td>-1.1%</td>
</tr>
<tr>
<td>Educational</td>
<td>83,679</td>
<td>83,077</td>
<td>85,576</td>
<td>0.7%</td>
<td>-2.2%</td>
</tr>
<tr>
<td>Water supply</td>
<td>12,805</td>
<td>13,215</td>
<td>13,293</td>
<td>-3.1%</td>
<td>-3.7%</td>
</tr>
<tr>
<td>Amusement and recreation</td>
<td>15,973</td>
<td>15,829</td>
<td>16,691</td>
<td>0.9%</td>
<td>-4.3%</td>
</tr>
<tr>
<td>Highway and street</td>
<td>78,710</td>
<td>78,178</td>
<td>82,350</td>
<td>0.7%</td>
<td>-4.4%</td>
</tr>
<tr>
<td>Communication</td>
<td>16,992</td>
<td>17,168</td>
<td>17,897</td>
<td>-1.0%</td>
<td>-5.1%</td>
</tr>
<tr>
<td>Conservation and development</td>
<td>5,765</td>
<td>5,563</td>
<td>6,359</td>
<td>3.6%</td>
<td>-9.3%</td>
</tr>
<tr>
<td>Religious</td>
<td>3,693</td>
<td>3,639</td>
<td>4,110</td>
<td>1.5%</td>
<td>-10.1%</td>
</tr>
<tr>
<td>Public safety</td>
<td>9,344</td>
<td>9,364</td>
<td>10,700</td>
<td>-0.2%</td>
<td>-12.7%</td>
</tr>
<tr>
<td>Sewage and waste disposal</td>
<td>20,733</td>
<td>22,635</td>
<td>23,816</td>
<td>-8.4%</td>
<td>-12.9%</td>
</tr>
</tbody>
</table>

### Employment, Seasonally Adjusted (in thousands)

<table>
<thead>
<tr>
<th>National Total Nonfarm</th>
<th>Dec-12</th>
<th>Nov-12</th>
<th>Dec-11</th>
<th>Nov-12</th>
<th>Dec-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>National Total Nonfarm</td>
<td>134,668</td>
<td>134,472</td>
<td>132,498</td>
<td>0.1%</td>
<td>1.6%</td>
</tr>
<tr>
<td>Construction</td>
<td>5,703</td>
<td>5,673</td>
<td>5,612</td>
<td>0.5%</td>
<td>1.6%</td>
</tr>
<tr>
<td>Residential building</td>
<td>574.4</td>
<td>574.2</td>
<td>575.6</td>
<td>0.0%</td>
<td>-0.2%</td>
</tr>
<tr>
<td>Nonresidential building</td>
<td>669.0</td>
<td>667.2</td>
<td>655.9</td>
<td>0.3%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Heavy and civil engineering construction</td>
<td>883.0</td>
<td>880.2</td>
<td>859.4</td>
<td>0.3%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Residential specialty trade contractors</td>
<td>1,501.9</td>
<td>1,489.8</td>
<td>1,461.9</td>
<td>0.8%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Nonresidential specialty trade contractors</td>
<td>2,074.6</td>
<td>2,061.6</td>
<td>2,058.9</td>
<td>0.6%</td>
<td>0.8%</td>
</tr>
</tbody>
</table>

### Producer Prices

<table>
<thead>
<tr>
<th></th>
<th>Dec-12</th>
<th>Nov-12</th>
<th>Dec-11</th>
<th>Nov-12</th>
<th>Dec-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finished Goods (seasonally adjusted)</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>-0.2%</td>
<td>1.3%</td>
</tr>
<tr>
<td>Inputs to Construction Industries</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>-0.1%</td>
<td>1.3%</td>
</tr>
<tr>
<td>Nonresidential Construction</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>-0.3%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Softwood lumber (not seasonally adjusted)</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>2.1%</td>
<td>17.3%</td>
</tr>
<tr>
<td>Concrete products (seasonally adjusted)</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>0.6%</td>
<td>2.4%</td>
</tr>
<tr>
<td>Crude energy (seasonally adjusted)</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>7.2%</td>
<td>-4.5%</td>
</tr>
<tr>
<td>Iron and steel (not seasonally adjusted)</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>0.8%</td>
<td>-8.4%</td>
</tr>
</tbody>
</table>

Sources: Bureau of Economic Analysis; U.S. Census Bureau; Bureau of Labor Statistics; NA = Not Applicable or Not Available

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  - Computer Forensics
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  - Computer Forensics
  - Business Valuation

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- Internal Controls and Governance
- Real Estate Advisory Services
- Family Office Services
- Risk Management

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