# MARCUM Commercial Construction Index

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IN THIS ISSUE



## Nonresidential Spending Emerges as One of Economy's Leading Engines

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### Pent-up Demand for Construction Services Impacting Marketplace

Nonresidential construction spending fell in September for the first time in eight months. This, however, is no cause for concern. Spending, which totaled $692.8 billion in September according to a November 2 release by the U.S. Census Bureau, exhibited its largest year-over-year increase since April 2008, five months before the pre-recession nonresidential construction spending peak. The month-over-month dip is partly a function of depressed construction materials prices—cheaper inputs allow contractors to offer their services at somewhat lower prices, all things being equal. The point is that most contractors are busier than they were one year ago.

Seven of 16 nonresidential construction sectors experienced spending increases in September on a monthly basis:

- Education-related spending expanded by 2 percent for the month and 11.5 percent for the year.
- Spending in the religious category grew by 5.6 percent on a monthly basis and 0.8 percent on a yearly basis.
- Amusement and recreation-related spending rose by 0.2 percent from August and 30.6 percent from September of last year.
- Transportation-related spending expanded by 1.6 percent from the previous month and 10.2 percent from a year ago.
- Highway and street-related construction spending inched 0.3 percent higher for the month and is up 10 percent from the same time last year.
- Sewage and waste disposal-related spending rose by 1.1 percent from August and 12.9 percent from September of last year.
- Spending in the water supply category gained 4.3 percent from the previous month and 5.6 percent on a year-ago basis.

One nonresidential construction segment that has been weak is power. Power-related spending totaled $126.9 billion on a seasonally adjusted annualized basis in February 2014. Ten months later, that figure had dipped by 37 percent, reaching a near-term trough of $80.2 billion. Lower energy prices are a likely culprit. Since then, the segment has exhibited steady growth, even in the face of still-low energy prices. September 2015 represented the first month in which the segment experienced spending growth on a year-over-year basis since August 2014. Power-related construction spending should continue to expand in 2016.

Spending in nine of the nonresidential construction subsectors fell in September on a monthly basis:

- Spending in the lodging category fell by 0.7 percent for the month but is up 32.8 percent for the year.
- Office-related spending dipped 0.4 percent from August but is 19.3 percent higher than at the same time last year.
- Spending in the commercial category fell by 1.1 percent on a monthly basis and by 2 percent on a yearly basis.
- Healthcare-related spending dropped 0.1 percent lower for the month but is up 9 percent for the year.
- Public safety-related spending fell 3 percent month-over-month and 4.8 percent year-over-year.
- Spending in the communication category declined 2.7 percent from August but is up 10.2 percent from the same time last year.
- Power-related construction spending fell 1.7 percent on a monthly basis but expanded 1.9 percent over the previous 12 months.
- Conservation and development-related spending lost 6 percent for the month but is still 1.6 percent higher than at the same time last year.
- Manufacturing-related spending fell 0.4 percent for the month but is still up 41.3 percent for the year.

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## Joe's View

What a difference a year makes. It makes me smile to see this data and learn about the great leaps of recovery our industry has made over the past year. Would you believe that we have reached a nearly 90% recovery in non-residential construction spending from its high point in 2008? You should – it's in the index. And how about this weather? Just in case you recall all of my past comments in this index (I surely do not), let me remind you that we spent a lot of time talking about frozen ground and its devastating effect on our jobs and our ability to do business. Look out your window, anywhere you are reading this, and you'll see mild weather. Heck, you might even see green leaves on the trees. It is all to the good for our industry.

If you look at the quarter-to-quarter changes among the sub-specialties that we track (e.g., Highway, Education, Healthcare, Public Safety, etc.), you will see that some are up and some are down. These are important data, but this isn't how we should judge our overall health, in the big picture. If you pull back and look at it from 30,000 feet, you can see that we have nine of the 16 categories demonstrating double-digit growth year-over year, including some remarkable results, such as 20% growth in office-related spending, 30% growth in amusement and rec, and (the real whopper!) 41% growth in manufacturing!

So, as usual, I'll end my glowing review with a caveat; a little caution to mix in with our enthusiasm. As you may have read here and as you have certainly heard in the news and everywhere else, the state of American politics is… complicated. Add to that an election amidst a recovery and a recovery highly dependent on very low interest rates (some would say, unsustainably low interest rates). In the coming year, should the Federal Reserve decide to make corrections to those rates, we will have some challenges to face. But, fear not! Based on the strength of the construction employment data reported in this index (125,000 fewer unemployed construction workers) and on the momentum we have built to date, I think we'll still be smiling come spring.

***Joseph Natarelli, CPA***
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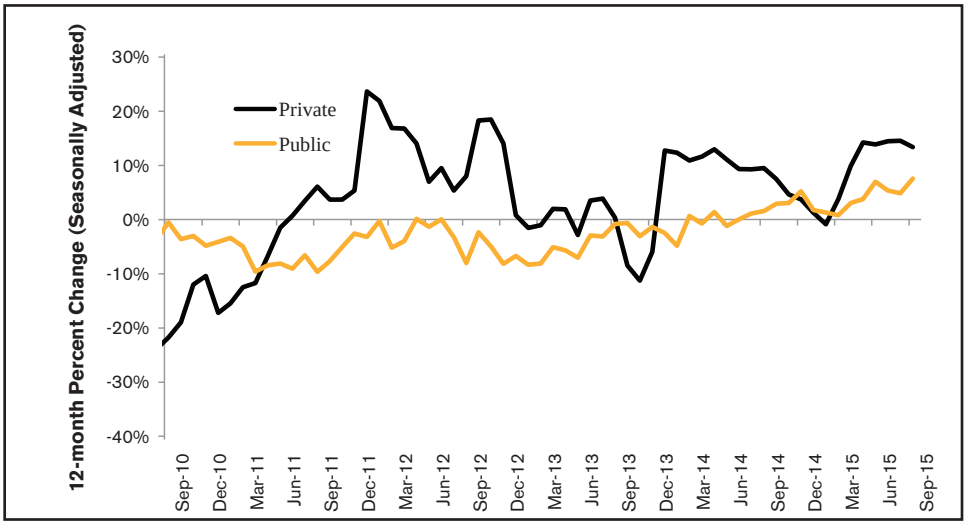
## Graph

**Exhibit 1** reflects the recent surge in overall nonresidential spending. That private sector growth is apparent is not particularly surprising. The U.S. economy is now in its 77th month of recovery, led largely by growth in consumer spending.

The expansion in public sector spending is, however, somewhat surprising given many years of sluggish government spending growth in the wake of the housing crisis and legislative gridlock in Washington, D.C. After sputtering during much of the economic recovery, public nonresidential construction spending has now expanded on a yearly basis for 19 consecutive months. Led by an uptick in highway and street-related spending (the largest public sector), public spending is finally supplying a boost for contractors, helping to lift backlog levels higher. This is largely attributable to rebounding revenues among state and local governments and greater confidence in allocating funds toward capital budgets. As of September, total nonresidential construction had regained 88 percent of the spending lost during the sector's downturn. The sector could be fully recovered by some point next year.

**Exhibit 1.** *Nonresidential Construction Spending, September 2010 through September 2015*




*Source: Census Bureau*

This is not to suggest that all is well. Federal Reserve policymaking has become confusing and less predictable. Interest rates could surge higher if the Federal Reserve fails to manage expectations or if inflation becomes more apparent. Over the past year, inflation has been largely kept at bay due to a collapse in energy prices. However, with the U.S. unemployment rate down to 5.1 percent and with energy prices poised to trend higher at some point, inflation could become more of an issue, driving interest rates, capitalization rates, and other key prices higher. That would be bad for construction or at least for most construction segments.

Moreover, employment growth has slowed in recent months. This appears to be related in large measure to softening in the U.S. manufacturing sector, due in part to a strengthening U.S. dollar. The September employment report was particularly disappointing, with the Bureau of Labor Statistics' preliminary estimate of net new job growth standing at 142,000. The estimate for August was revised lower; the average workweek shrank; and the labor force participation rate fell to its lowest level since October 1977.

Viewed in light of this disappointing report, U.S. construction industry employment growth was perfectly acceptable in September. According to an October 2 report made available by the Bureau of Labor Statistics, the construction industry added 8,000 workers on a seasonally adjusted basis in September. The nonresidential sector accounted for 6,800 of those net new jobs. Construction employment is up by 205,000 positions since September 2014, one of the best performances of any industry in both absolute and percentage terms. The industry's unemployment rate has fallen by 1.5 percentage points over the past year, and there are now 125,000 fewer unemployed construction workers than there were a year ago. Industry employment growth would have been even more rapid but for the fact that many contractors are experiencing greater difficulty filling available positions. Many contractors are now turning away work for the first time in years.

**Exhibit 2.** *Construction Employment Growth in 20 Largest U.S. Metropolitan Areas September 2014 v. September 2015, Not Seasonally Adjusted*

| Rank | MSA | Percent Change |
|---|---|---|
| 1 | Seattle-Tacoma-Bellevue, WA | 9.4% |
| 2 | Phoenix-Mesa-Glendale, AZ | 8.7% |
| 3 | Philadelphia-Camden-Wilmington, PA-NJ-DE-MD* | 8.0% |
| 4 | San Diego-Carlsbad-San Marcos, CA | 7.7% |
| 5 | Boston-Cambridge-Quincy, MA-NH | 6.7% |
| 6 | Los Angeles-Long Beach-Santa Ana, CA | 5.8% |
| 7 | Atlanta-Marietta, GA | 5.4% |
| 8 | Tampa-St. Petersburg-Clearwater, FL | 5.2% |
| 9 | Riverside-San Bernardino-Ontario, CA | 4.6% |
| 10 | San Francisco-Oakland-Fremont, CA | 4.2% |
| 11 | Miami-Fort Lauderdale-Pompano Beach, FL | 3.5% |
| 11 | Baltimore-Towson, MD* | 3.5% |
| 13 | New York-Northern New Jersey-L. Island, NY-NJ-PA* | 2.6% |
| 14 | Detroit-Warren-Livonia, MI* | 2.4% |
| 14 | Chicago-Joliet-Naperville, IL-IN-WI | 2.4% |
| 16 | Washington-Arlington-Alexandria, DC-VA-MD-WV* | 2.3% |
| 17 | Minneapolis-St. Paul-Bloomington, MN-WI* | 0.3% |
| 18 | St. Louis, MO-IL | -1.4% |
| 19 | Houston-Sugar Land, TX | -1.6% |
| 20 | Dallas-Fort Worth-Arlington, TX* | -2.1% |

**Construction, Mining, and Logging are included in one industry; source: Bureau of Labor Statistics*

### Looking Ahead

Interest rates will play a central role in economic affairs in 2016. Perhaps that's true for any given year, but next year will represent a special case. The U.S. economy continues to expand at a roughly 2–2.5 percent pace. Many of the segments driving the economy forward are heavily influenced by interest rates, including housing, nonresidential construction and autos. Were interest rates to rise meaningfully next year, the still-fragile economy would suffer some difficulty adjusting.

The Federal Reserve decided against raising short-term rates in September. Though much of the explanation for the decision centered on global economic weakness, the fact of the matter is that America's economic recovery remains heavily dependent on unusually low interest rates. At the same time, those ultra-low interest rates may be generating distortions in capital markets; distortions that ultimately may mature into the next U.S. recession.

This doesn't mean, however, that 2016 will be a problematic year. Wage growth should accelerate next year, helping to push consumer spending ahead. State and local government spending will also be stronger, including in key construction segments like education, water supply and waste disposal.

| Third Quarter 2015 Performance | Quarterly Values | | | % Change from | |
|---|---|---|---|---|---|
| **Gross Domestic Product** | **2015Q3** | **2015Q2** | **2015Q1** | | |
| Overall Real GDP | 1.5% | 3.9% | 0.6% | NA | NA |
| Nonresidential Fixed Investment in Structures | -4.0% | 6.2% | -7.4% | NA | NA |
| **Construction Spending, Seasonally Adjusted (in $millions)** | **Sep-15** | **Aug-15** | **Sep-14** | **Aug-15** | **Sep-14** |
| Total Construction | 1,094,160 | 1,087,511 | 959,182 | 0.6% | 14.1% |
| Residential | 401,321 | 394,066 | 342,529 | 1.8% | 17.2% |
| Nonresidential | 692,840 | 693,445 | 616,654 | -0.1% | 12.4% |
| Lodging | 22,362 | 22,511 | 16,845 | -0.7% | 32.8% |
| Office | 57,509 | 57,731 | 48,207 | -0.4% | 19.3% |
| Commercial | 65,782 | 66,544 | 67,095 | -1.1% | -2.0% |
| Healthcare | 41,349 | 41,382 | 37,926 | -0.1% | 9.0% |
| Educational | 87,635 | 85,953 | 78,587 | 2.0% | 11.5% |
| Religious | 3,373 | 3,194 | 3,345 | 5.6% | 0.8% |
| Public safety | 9,075 | 9,352 | 9,529 | -3.0% | -4.8% |
| Amusement and recreation | 22,041 | 21,989 | 16,871 | 0.2% | 30.6% |
| Transportation | 45,940 | 45,215 | 41,694 | 1.6% | 10.2% |
| Communication | 18,339 | 18,846 | 16,639 | -2.7% | 10.2% |
| Power | 91,392 | 93,006 | 89,700 | -1.7% | 1.9% |
| Highway and street | 91,642 | 91,328 | 83,307 | 0.3% | 10.0% |
| Sewage and waste disposal | 26,008 | 25,726 | 23,038 | 1.1% | 12.9% |
| Water supply | 14,500 | 13,903 | 13,736 | 4.3% | 5.6% |
| Conservation and development | 8,135 | 8,651 | 8,007 | -6.0% | 1.6% |
| Manufacturing | 87,758 | 88,114 | 62,127 | -0.4% | 41.3% |
| **Employment, Seasonally Adjusted (in thousands)** | **Sep-15** | **Aug-15** | **Sep-14** | **Aug-15** | **Sep-14** |
| National Total Nonfarm | 142,371 | 142,229 | 139,619 | 0.1% | 2.0% |
| Construction | 6,396 | 6,388 | 6,191 | 0.1% | 3.3% |
| Residential building | 695.3 | 694.5 | 674.9 | 0.1% | 3.0% |
| Nonresidential building | 715.6 | 714.4 | 701.3 | 0.2% | 2.0% |
| Heavy and civil engineering construction | 943.1 | 945.3 | 919.9 | -0.2% | 2.5% |
| Residential specialty trade contractors | 1,764.5 | 1,761.4 | 1,684.9 | 0.2% | 4.7% |
| Nonresidential specialty trade contractors | 2,277.8 | 2,272.2 | 2,209.7 | 0.2% | 3.1% |
| **Producer Prices** | **Sep-15** | **Aug-15** | **Sep-14** | **Aug-15** | **Sep-14** |
| Finished Goods (seasonally adjusted) | 192.3 | 192.4 | 188.3 | -0.1% | 2.1% |
| Inputs to Construction Industries | 209.6 | 213.0 | 221.4 | -1.6% | -5.3% |
| Softwood lumber (seasonally adjusted) | 189.3 | 196.8 | 215.6 | -3.8% | -12.2% |
| Concrete products (seasonally adjusted) | 240.2 | 238.6 | 233.3 | 0.7% | 3.0% |
| Crude energy materials (seasonally adjusted) | 135.1 | 136.4 | 224.8 | -1.0% | -39.9% |
| Iron and steel (not seasonally adjusted) | 190.0 | 192.1 | 233.9 | -1.1% | -18.8% |

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

# Services

Marcum LLP is one of the largest independent public accounting and advisory services firms in the nation. Marcum offers the resources of more than 1,400 professionals in 25 full-service offices in the U.S., China and Grand Cayman. Marcum's comprehensive services accommodate companies of all sizes in varied industries. From start-up through growth, merger or acquisition, to public listing or ownership transition, Marcum professionals guide businesses every step of the way.

## Assurance

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- Attestation
- Financial Audits Reviews and Compilations
- Breakeven Analyses
- Single Audits
- Sarbanes-Oxley 404 Compliance
- Forecasts and Projections
- Internal Audits
- Internal Control Reviews
- IT Audit and Advisory Services
- Strategic and Operational Planning

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- Family Wealth Planning
- Bankruptcy and Insolvency Tax
- State and Local Taxation
- SEC and Large Corporate Matters
- International Taxation
- Real Estate Tax Services
- IRS Representation

With partner involvement at every level of service, the Tax & Business Services team provides highly personalized advice and guidance to a client base including:

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- Family Business Owners
- Large Corporations
- International Businesses
- Foreign Nationals
- Tax Exempt Clients

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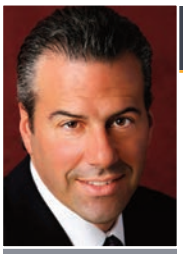
- Insolvency and Receivership
- Trustee, Reorganization and Financial Advisory Services

**Forensic and Litigation Services**

- Forensic Accounting and Fraud Assessment
- Damage Determination and Expert Testimony
- Marital Dissolution
- Regulatory Compliance, including Bank Secrecy Act and Taxation
- Due Diligence and Capital Formation
- Computer Forensics
- Business Valuation

**Operational & Process Improvement**

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



## Joseph Natarelli

Joseph Natarelli is the national leader of Marcum's Construction Industry Practice and partner-in-charge of the Firm's New Haven office. For nearly a decade, he has served as a technical reviewer for the AICPA's Audit Risk Alert for Construction Contractors and the AICPA Accounting Guide – Construction Contractors. Joe also served as 2013-2014 chair of the AICPA National Construction Industry Conference.

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