MARCUM Commercial Construction Index

Issue 9
THIRD QUARTER 2014

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Momentum Starts to Build-in Third Quarter

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Two consecutive quarters of meaningful growth has been a rarity for the U.S. economy since the recovery began in 2009. The dominant pattern has been one of good quarter, bad quarter, good quarter, bad quarter. The third quarter of 2014 marks an end to the inconsistency. The U.S. economy expanded at a 3.5 percent pace during the third quarter of 2014 on an annualized basis. This follows an expansion of 4.6 percent annualized in the second quarter. Despite concerns pertaining to the global economy, confidence is high regarding the U.S. outlook, and continued momentum seems likely.

In September, nonresidential construction spending shrank one percent on a monthly basis following a 0.6 percent decrease in August and a 0.8 percent increase in July. This is hardly a cause for concern. While it is disappointing to see construction spending fall in consecutive months, industry-specific economic indicators continue to present positive signals. Expect nonresidential construction spending to re-establish an upward trajectory in the coming months.

Only five of sixteen nonresidential construction subsectors posted increases in spending in September on a monthly basis. That said, spending in four of the five sectors was more than 10 percent higher on a year-over-year-basis. This is a bit misleading, however. For example, construction spending in conservation and development is up more than 30 percent on a year-over-year basis, but is a disproportionately small piece of total construction spending. So despite the strong performance in this subsector, it accounts for less than one percent of nonresidential construction spending overall.

- Office-related construction spending grew by 2.4 percent in September and is up 15.7 percent from the same time one year ago.
- Lodging construction spending is up 4.7 percent on a monthly basis and is up 14.7 percent on a year-over-year basis.
- Conservation and development-related construction spending grew 4.1 percent for the month and is up 31.7 percent on a yearly basis.
- Commercial construction spending gained 1.3 percent for the month and has grown 12.3 percent on a year-over-year basis.
- Spending in the water supply category expanded 1.1 percent on a monthly basis, but is down 1.6 percent for the year.

Spending in the remaining eleven nonresidential construction subsectors declined in September. While seven of these sectors posted increases year-over-year, manufacturing stands out. In fact, the increase in spending within the manufacturing sector accounted for 32 percent of the total increase in nonresidential spending over the past 12 months.

- Amusement and recreation-related construction spending lost 0.8 percent in September, but is up 0.6 percent from the same time last year.
- Manufacturing-related spending fell 1.3 percent on a monthly basis, but is up 16.4 percent for the year.
- Communication construction spending declined 0.7 percent for the month and is down 12.8 percent for the year.
- Religious spending fell 3.1 percent for the month, but is up 2.6 percent from the same time last year.
- Sewage and waste disposal-related construction spending declined 2.4 percent for the month, but has expanded 1.1 percent on a 12-month basis.
- Health care-related construction spending fell 0.9 percent for the month and is down 7.5 percent for the year.
- Education-related construction spending fell 0.1 percent for the month, but is up 7.1 percent on a year-over-year basis.
- Construction spending in the transportation category fell 1.1 percent on a monthly basis, but has expanded by 1.2 percent on an annual basis.
- Highway and street-related construction spending fell 3.6 percent in September and is down 1.7 percent compared to the same time last year.
- Public safety-related construction spending lost 2.3 percent on a monthly basis and is down 11.1 percent on a year-over-year basis.
- Power construction spending fell 3.1 percent for the month, but is 2.0 percent higher than at the same time one year ago.

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Joe's View

Luck and Opportunity

The construction industry, as noted in this quarterly index and forecasted in our last, appears to be back on its feet and ready to build America. Backlogs are filling and profit margins are viable if not robust, just yet. All signs point to a healthy industry, I'm very happy to report. In this most recent index one piece of new data nearly jumps off the page: the national construction unemployment rate has dropped below 7% as of October...that's a pre-2008 great recession number!

So what, then, should we be looking out for? It can't all be rainbows and dollar signs, can it?

Well, it's true that while things look good, it is impossible to control all the variables and success is never, ever guaranteed. Someone very wise once said that "luck is what happens when preparation meets opportunity." So, as we move forward through the fourth quarter I turn my gaze to the clouds (more truthfully, to the weather gods) and I wonder: How will our luck be this year? Are we prepared for a polar vortex, for punishing snow dumps (ala Buffalo, NY) and work stoppages? Have we learned from the past, will seasonal stoppages in intemperate areas be a pattern going forward, and how will we as an industry adjust to that?

Far be it from me to be pessimistic in the face of the good news the third quarter delivered. Things look good. Other people are saying that things look good. It's now up to us, as an industry, to do our best to be prepared for the opportunity that 2015 will bring.

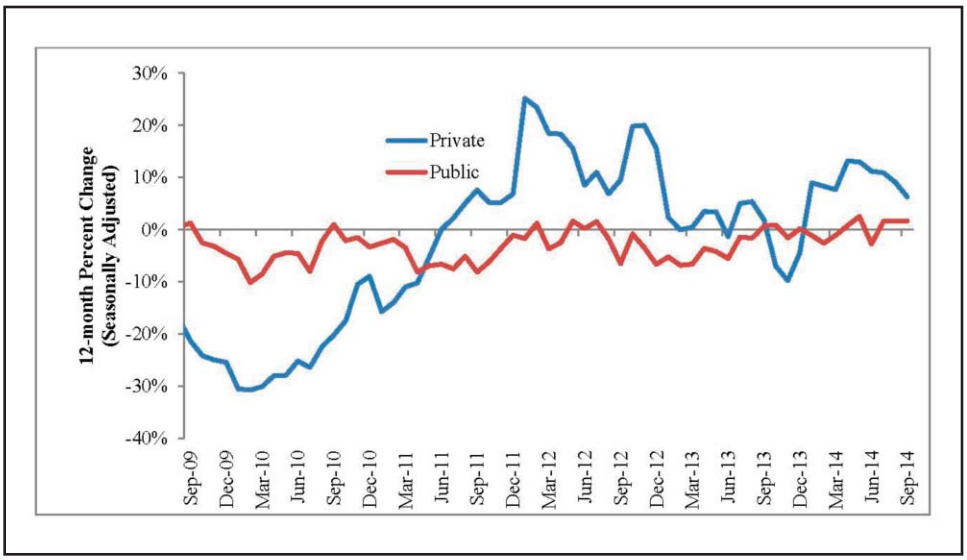
I want to wish all of you and your families a very happy holiday season and a healthy New Year!

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

Graph

Exhibit 1 reflects the fact that nonresidential construction spending continues to be hampered by public stagnation. Note that it has been over 5 years since public sector non-residential spending exhibited any kind of meaningful growth. Don't expect that to change anytime soon. While some public categories exhibited seemingly large year-over-year gains, namely conservation and development, which expanded almost 30 percent, note that those sectors account for a very insignificant portion of public sector spending. Meanwhile, growth in the private sector has been both consistent and robust. Private nonresidential spending has expanded by at least 6 percent in each of the past 9 months. As U.S. growth continues, expect the private sector to expand accordingly.

Exhibit 1. *Nonresidential Construction Spending, September 2009 through September 2014*



Source: Census Bureau

The U.S. construction industry added 12,000 jobs in October according to the Bureau of Labor Statistics' preliminary estimate released on November 7, but nonresidential construction actually shed 1,900 positions on a month-to-month basis. Both nonresidential building construction and nonresidential specialty trade contractors lost jobs for the month, though both segments have still added jobs on a year-over-year basis. Based on leading indicators such as the Architecture Billings Index and surveys of backlog, October likely reflects a mere blip. Nonresidential construction's fortunes are shifting, with 2015 shaping up to be the best year in many for a significant fraction of contractors.

The national construction unemployment rate dropped from 7 percent to 6.4 percent on a non-seasonally adjusted basis in October, its lowest level since November 2007, the month before the recession began. The combination of a plummeting unemployment rate and stagnant employment suggests that the long-feared construction labor shortage may be upon us, soon. In states like Texas, Louisiana, and North Dakota, it's already here.

One of the most remarkable aspects of the current construction recovery has been the comeback experienced by some of the communities most impacted by the Great Recession – communities like Southern California, Miami, Las Vegas, and Atlanta. These regions are all benefiting from a combination of more stable housing markets and population growth. Markets with large technology sectors like San Francisco and Seattle are also performing strongly. Energy-intensive markets like Houston and Dallas have also been at the vanguard of economic growth, and that should continue despite the recent drop in oil prices.

Exhibit 2. *Construction Employment Growth in Twenty Largest U.S. Metropolitan Areas September 2013 v. September 2014, Not Seasonally Adjusted*

Rank	MSA	Percent Change
1	San Diego-Carlsbad-San Marcos, CA	10.2%
2	Los Angeles-Long Beach-Santa Ana, CA	8.8%
3	Detroit-Warren-Livonia, MI*	8.3%
4	St. Louis, MO-IL*	8.3%
5	Miami-Fort Lauderdale-Pompano Beach, FL	8.2%
6	San Francisco-Oakland-Fremont, CA	7.7%
7	Houston-Sugar Land, TX	7.1%
8	Philadelphia-Camden-Wilmington, PA-NJ-DE-MD*	6.9%
9	Dallas-Fort Worth-Arlington, TX*	6.9%
10	Baltimore-Towson, MD*	6.5%
11	Seattle-Tacoma-Bellevue, WA	4.6%
12	Atlanta-Marietta, GA	4.1%
13	Chicago-Joliet-Naperville, IL-IN-WI	4.0%
14	Riverside-San Bernardino-Ontario, CA	2.6%
15	Tampa-St. Petersburg-Clearwater, FL	2.4%
16	Washington-Arlington-Alexandria, DC-VA-MD-WV*	1.0%
17	Boston-Cambridge-Quincy, MA-NH	0.6%
18	Minneapolis-St. Paul-Bloomington, MN-WI*	0.1%
19	New York-Northern New Jersey-L. Island, NY-NJ-PA*	-0.3%
20	Phoenix-Mesa-Glendale, AZ	-7.2%

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

Looking Ahead

The nation is now well into its sixth year of economic recovery. During each of the past 9 months, the country has added more than 200,000 jobs, the first time that has occurred since the mid-1990s. The national unemployment rate is now below 6 percent, and the quality of jobs being added has begun to improve, in part because of ongoing employment growth in manufacturing, construction, energy, professional services, logistics and finance.

Given substantial economic momentum, a booming stock market, and accommodative monetary policy, the economy is on its way to having its best post-recession year. There are, of course, items that could trip things up, including the classic Black Swans (potential low-probability, high-impact events that can alter the trajectory of an economy), but the baseline forecast is quite positive.

One of the major questions is when corporations will begin to deploy more of their cash into the Main Street economy. The answer could very well be 2015. Corporations have been extremely profitable in general and to continue to grow profits will likely require an acceleration of investment.

Global economic growth continues to be a concern. Europe's woes have deepened over the course of the year, and the economies of Russia, Japan and Brazil remain shaky. That could lead to soft U.S. export growth next year, particularly in light of a strengthening U.S. dollar.

That notwithstanding, the U.S. economy should still post solid numbers next year. Consumer confidence is up, fueled in part by lower gas prices. The public sector is becoming less of a drag, and shale-related development continues to power both the nation's energy and industrial sectors. All of this bodes well for construction in 2015.

Third Quarter 2014 Performance	Quarterly Values			% Change from	
Gross Domestic Product	**2014Q3**	**2014Q2**	**2014Q1**	**2014Q2**	**2013Q3**
Overall Real GDP	3.5%	4.6%	-2.1%	NA	NA
Nonresidential Fixed Investment in Structures	4.7%	9.5%	0.2%	NA	NA
Construction Spending, Seasonally Adjusted (in $millions)	**Sep-14**	**Aug-14**	**Sep-13**	**Aug-14**	**Sep-13**
Total Construction	950,920	955,172	924,153	-0.4%	2.9%
Residential	354,834	353,248	352,235	0.4%	0.7%
Nonresidential	596,086	601,924	571,917	-1.0%	4.2%
Lodging	16,591	15,847	14,470	4.7%	14.7%
Office	44,769	43,728	38,679	2.4%	15.7%
Commercial	57,964	57,207	51,626	1.3%	12.3%
Healthcare	38,185	38,549	41,284	-0.9%	-7.5%
Educational	79,617	79,705	74,306	-0.1%	7.1%
Religious	3,629	3,745	3,538	-3.1%	2.6%
Public safety	8,641	8,840	9,724	-2.3%	-11.1%
Amusement and recreation	16,416	16,549	16,319	-0.8%	0.6%
Transportation	40,442	40,873	39,977	-1.1%	1.2%
Communication	15,760	15,879	18,065	-0.7%	-12.8%
Power	95,240	98,314	93,380	-3.1%	2.0%
Highway and street	80,079	83,100	81,501	-3.6%	-1.7%
Sewage and waste disposal	22,779	23,342	22,531	-2.4%	1.1%
Water supply	13,118	12,974	13,336	1.1%	-1.6%
Conservation and development	8,039	7,724	6,104	4.1%	31.7%
Manufacturing	54,819	55,551	47,080	-1.3%	16.4%
Employment, Seasonally Adjusted (in thousands)	**Oct-14**	**Sep-14**	**Oct-13**	**Sep-14**	**Oct-13**
National Total Nonfarm	139,680	139,466	137,037	0.2%	1.9%
Construction	6,095	6,083	5,864	0.2%	3.9%
Residential building	676.2	678.5	626.3	-0.3%	8.0%
Nonresidential building	695	696.8	676.8	-0.3%	2.7%
Heavy and civil engineering construction	928	922.5	889.7	0.6%	4.3%
Residential specialty trade contractors	1,641	1,632	1,561	0.6%	5.1%
Nonresidential specialty trade contractors	2,154	2,154	2,110	0.0%	2.1%
Producer Prices	**Sep-14**	**Aug-14**	**Sep-13**	**Aug-14**	**Sep-13**
Finished Goods (seasonally adjusted)	201.1	201.6	196.9	-0.2%	2.1%
Inputs to Construction Industries	221.2	221.5	217.8	-0.1%	1.6%
Softwood lumber (seasonally adjusted)	216.2	210.5	196.2	2.7%	10.2%
Concrete products (seasonally adjusted)	230.7	231.4	222.6	-0.3%	3.6%
Crude energy (seasonally adjusted)	223.6	225.9	242.7	-1.0%	-7.9%
Iron and steel (not seasonally adjusted)	234.2	233.0	223.9	0.5%	4.6%

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

Services

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- Breakeven Analyses
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- Internal Control Reviews
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- Family Wealth Planning
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- SEC and Large Corporate Matters
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- Family Business Owners
- Large Corporations
- International Businesses
- Foreign Nationals
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- Trustee, Reorganization and Financial Advisory Services

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- 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 is also 2013-2014 Chair of the AICPA National Construction Industry Conference.

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