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Nonresidential Construction's Recovery Has Stalled

By Anirban Basu, *Chief Construction Economist at Marcum LLP*

During the third quarter of 2012, the U.S. economy expanded for a 13th consecutive quarter. Unfortunately, nonresidential construction has not been among the economic segments experiencing meaningful recovery. While the broader economy expanded at a 2 percent annualized rate during the third quarter, due in part to ongoing consumer spending growth, nonresidential investment declined 4.4 percent on an annualized basis following a modest 0.6 percent gain during the second.

In fact, nonresidential construction spending recently declined for four consecutive months. In September, overall nonresidential construction spending dipped 0.4 percent to a seasonally adjusted annual rate of \$559.4 billion. Both private and public nonresidential construction spending contributed to the monthly decrease, with private nonresidential construction spending slipping 0.1 percent and public nonresidential spending declining 0.8 percent. Year-over-year, total nonresidential construction

spending is up 2.6 percent, a reflection of the fact that there was a time earlier this year when nonresidential construction momentum was more readily apparent.

Among the most rapidly recovering non-residential construction segments are the lodging and power segments, which through September had posted 25 percent and 19.2 percent spending growth respectively on a year-over-year basis. Transportation spending is also up 11 percent. Many of the nation's largest ongoing construction projects fall within one of these categories, including O'Hare Airport's modernization, which comes with a price tag of \$8.8 billion; the Dulles transit extension in the Washington metropolitan area, which will cost approximately \$6.2 billion; the Alaskan Way Viaduct with a projected cost of \$3.1 billion; and the Shepherd's Flat Wind Farm in Oregon, with a projected cost of \$2 billion.

Sectors primarily associated with state and local government capital funding have experienced the largest decreases in construction spending over the past year. These include water supply, down 12.7 percent; conservation and development, down 6.5 percent; education, down 3.2 percent; and highway and street, down 2.2 percent.

Of late, markets in the western United States have been among the best performers in terms of experiencing rising construction volumes. Materially improved economic performance in markets like Los Angeles, Phoenix and even Las Vegas have helped to push construction backlog higher in the West according to data from Associated Builders and Contractors. Construction momentum has dissipated in much of the southern United States, however, due in part to a slowdown in industrial production. Alabama has shed 4,300 construction jobs over the past year and Mississippi has lost roughly 3,300.

The agonizingly slow recovery in non-residential construction spending is attributable to many factors, including fiscal cliff fears, tight credit, cautious developers and stubbornly high vacancy rates in many market segments. Concerns emerging from other parts of the global economy are also having an impact. With the elections now behind us, the hope is that the White House and Congress will be able to successfully navigate the nation past the fiscal cliff. If that happens, the latter half of 2013 could be surprisingly good given the large volume of construction projects that were put on hold over the course of 2012.

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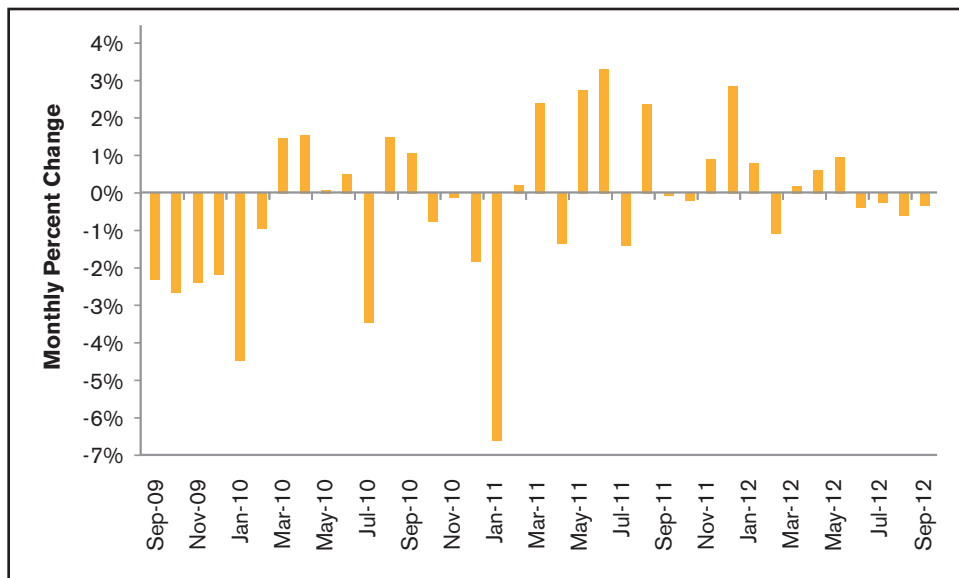
As the construction practice leader for Marcum, I spend all of my time out in the field, working closely with construction contractors around the country and I get a pretty good look at the day-to-day economics of the construction business in our towns and cities. I've even been known to work on a financial statement or two. Based on my first-hand observations and what people in the industry are telling me, the American construction industry is recovering. But... it's still early in that recovery and it will be, no doubt, a slow one.

Why so slow, Joe? You may ask. Dollars and cents, as always. I'm seeing gross profit margins that are very thin for construction contractors right now. Pair that with a tightening of bonding and banking access and you can only recover so fast.

But, it's not all bad. There are things you can do that will help. I'll tell you exactly what I tell construction contractors at conferences, around the country, when they ask "what more can we do to succeed?" First, make certain that your balance sheet is well capitalized... this must simply be the case in order to obtain the surety and bank credit necessary to perform the new work you so desire. Can't do it without it. And second, as always, when it comes to specialty areas such as construction, having a good professional service provider isn't enough. Make sure you're working with the experts.

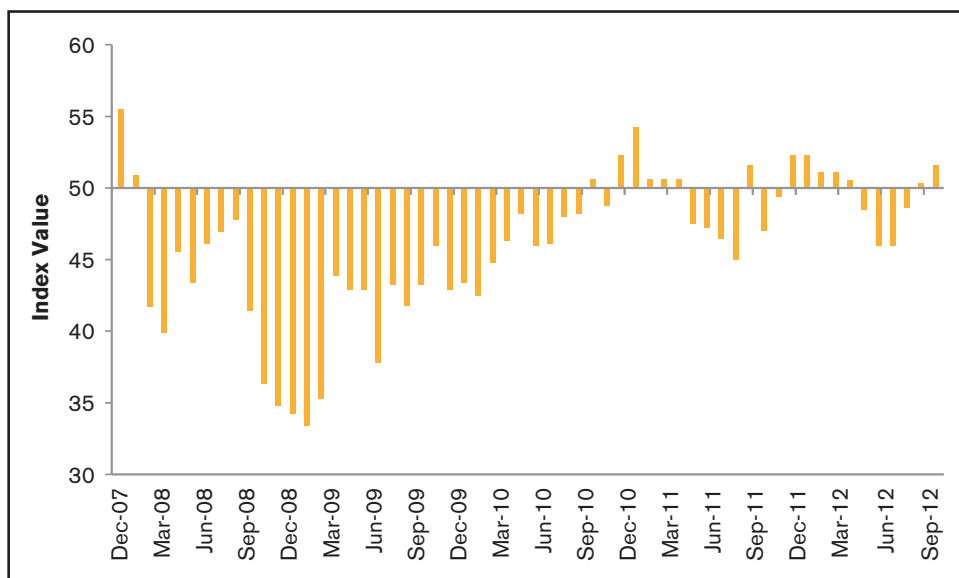
Joseph Natarelli, CPA
 National Construction Industry
 Group Leader at Marcum LLP

▼ **Exhibit 1.** *Monthly Nonresidential Construction Spending Growth September 2009 through September 2012*



Source: U.S. Census Bureau

▼ **Exhibit 2.** *Architecture Billings Index, December 2007 through September 2012*



Source: The American Institute of Architects; figures below 50 indicate contraction in billing

Third Quarter 2012 Performance	Quarterly Values			% Change from	
Gross Domestic Product	2012Q3	2012Q2	2011Q3	2012Q2	2011Q3
Real GDP Growth	2.0%	1.30%	2.0%	NA	NA
Nonresidential Fixed Investment in Structures Growth	-4.4%	0.6%	20.7%	NA	NA
Construction Spending, Seasonally Adjusted (in \$millions)	Sep-12	Aug-12	Sep-11	Aug-12	Sep-11
Total Construction	851,563	846,167	790,294	0.6%	7.8%
Residential	292,163	284,447	245,041	2.7%	19.2%
Nonresidential	559,400	561,720	545,253	-0.4%	2.6%
Lodging	11,230	11,537	8,981	-2.7%	25.0%
Power	89,731	88,541	75,283	1.3%	19.2%
Transportation	38,516	37,607	34,709	2.4%	11.0%
Office	35,848	36,633	35,011	-2.1%	2.4%
Commercial	45,400	47,540	44,564	-4.5%	1.9%
Manufacturing	47,973	46,333	47,605	3.5%	0.8%
Amusement and recreation	16,039	15,603	16,028	2.8%	0.1%
Health care	40,600	42,674	40,595	-4.9%	0.0%
Communication	17,806	16,742	17,989	6.4%	-1.0%
Public safety	9,973	10,106	10,168	-1.3%	-1.9%
Highway and street	78,532	79,781	80,308	-1.6%	-2.2%
Sewage and waste disposal	21,543	21,642	22,027	-0.5%	-2.2%
Educational	83,815	84,407	86,626	-0.7%	-3.2%
Conservation and development	6,404	6,229	6,848	2.8%	-6.5%
Water supply	12,438	12,561	14,240	-1.0%	-12.7%
Religious	3,553	3,785	4,272	-6.1%	-16.8%
Employment, Seasonally Adjusted (in thousands)	Sep-12	Aug-12	Sep-11	Aug-12	Sep-11
National Total Nonfarm	133,584	133,436	131,694	0.1%	1.4%
Construction	5,522	5,520	5,528	0.0%	-0.1%
Residential building	562.3	562.9	561.9	-0.1%	0.1%
Nonresidential building	658.6	655.5	667.3	0.5%	-1.3%
Heavy and civil engineering construction	841.5	843.0	829.4	-0.2%	1.5%
Residential specialty trade contractors	1,466.3	1,465.8	1,448.8	0.0%	1.2%
Nonresidential specialty trade contractors	1,993.4	1,992.8	2,021.1	0.0%	-1.4%
Producer Prices	Sep-12	Aug-12	Sep-11	Aug-12	Sep-11
Finished Goods (seasonally adjusted)	NA	NA	NA	1.1%	2.2%
Inputs to Construction Industries	NA	NA	NA	0.9%	1.7%
Nonresidential Construction	NA	NA	NA	1.2%	1.6%
Softwood lumber (not seasonally adjusted)	NA	NA	NA	2.6%	11.7%
Concrete products (seasonally adjusted)	NA	NA	NA	0.1%	2.1%
Crude energy (seasonally adjusted)	NA	NA	NA	4.4%	-6.1%
Iron and steel (not seasonally adjusted)	NA	NA	NA	0.5%	-8.9%

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 1,100 professionals in 23 full-service offices strategically located in major business markets in the U.S. and abroad. 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

Marcum's Assurance division professionals provide a tailored audit approach to each engagement. Team members place a strong emphasis on early planning and learning the unique aspects of a client's business. Doing so ensures that each client receives an effective, cost-efficient and independent audit performed in a timely manner.

The Assurance division works with commercial and SEC clients, governmental and not-for-profit entities and employee retirement plans. A full range of services is offered including:

- ▶ Agreed-Upon Procedures
- ▶ 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
- ▶ Public Company Filings
- ▶ Strategic and Operational Planning

▼ Tax & Business

The Tax & Business Services division is comprised of dedicated professionals who have been involved with numerous complex transactions at the local, national and international levels.

The division offers all forms of regulatory compliance services, planning and specialization in a variety of areas including:

- ▶ Estates, Gifts and Trusts
- ▶ 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:

- ▶ High-Net-Worth Individuals
- ▶ Family Business Owners
- ▶ Large Corporations
- ▶ International Businesses
- ▶ Foreign Nationals
- ▶ Tax Exempt Clients

▼ Advisory

Marcum's Advisory Services division works with clients across a broad range of industries. The team's skilled professionals use their experience to help clients address and navigate complex business and personal issues including:

Bankruptcy and Fiduciary Services

- ▶ 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 Partner-In-Charge of the Firm's New Haven office as well as the National Construction Industry Group Leader. 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 2012-2014 Chair of the AICPA National Construction Industry Conference.



▼ Anirban Basu

Anirban Basu is Marcum's Chief Construction Economist. He is also a member of the Firm's National Construction practice, as well as Chairman & CEO of Sage Policy Group, Inc., an economic and policy consulting firm in Baltimore, Maryland. Mr. Basu leads Marcum's research and analysis of the economic health of the commercial construction industry in America. Additionally, Mr. Basu creates and produces the quarterly Marcum Commercial Construction Industry Index.

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