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Issue 2
FOURTH QUARTER 2012

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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 sub-

stantial 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.

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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.

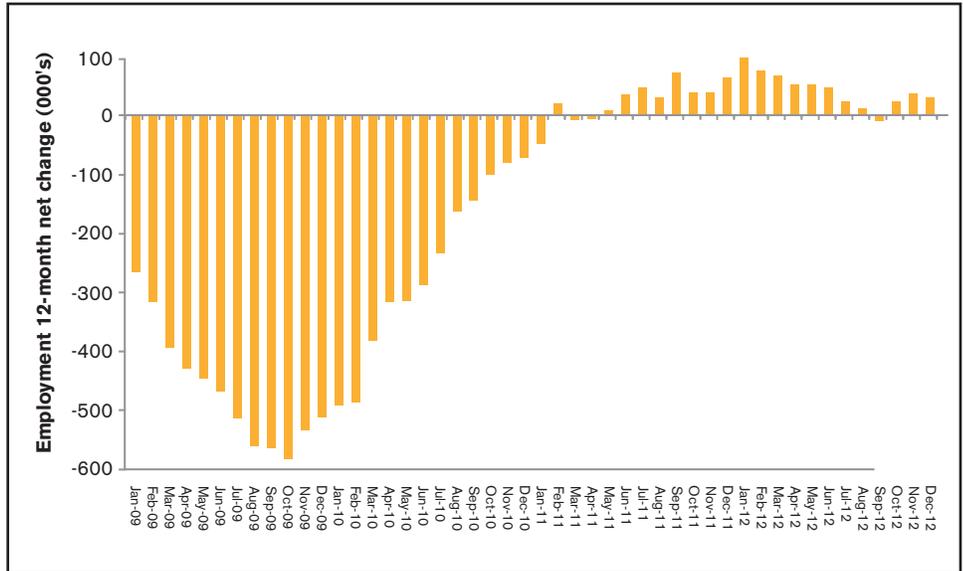
Our business, the construction business, can be a tricky one to forecast – largely due to the industry-specific nature of the “backlog.” Backlogged business forestalls the immediate economic influences that so dramatically affect the rest of the world on both ends – for better and for worse. Compounding 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 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
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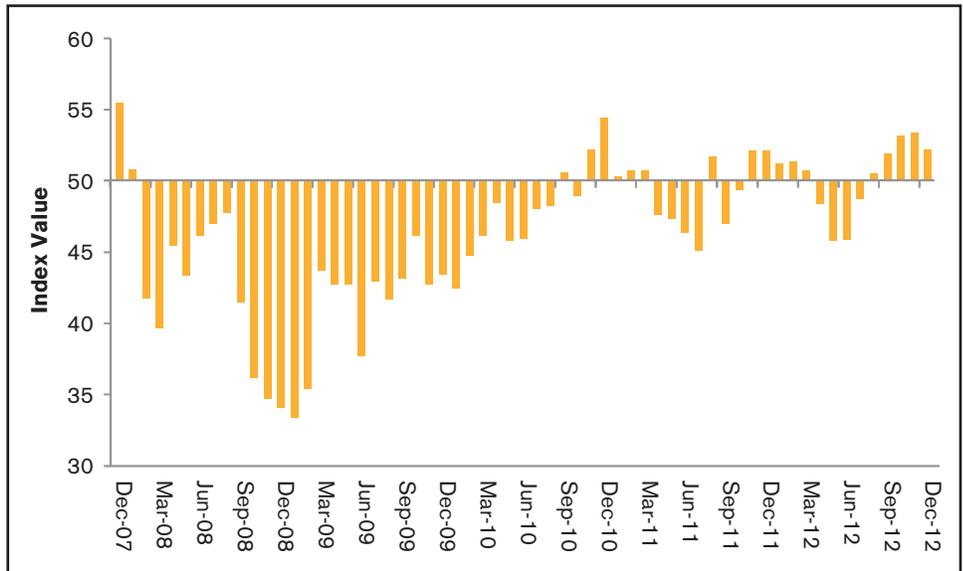
▼ **Exhibit 1.** Monthly Nonresidential Construction Employment Jan. 2009 through Dec. 2012



Nonresidential construction employment = Nonresidential building + Nonresidential specialty trade contractors

Source: Bureau of Labor Statistics

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



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

Fourth Quarter 2012 Performance	Quarterly Values			% Change from	
Gross Domestic Product	2012Q4	2012Q3	2011Q4	2012Q2	2011Q3
Overall Real GDP	-0.1%	3.1%	4.1%	NA	NA
Nonresidential Fixed Investment in Structures	-1.1%	0.0%	11.5%	NA	NA
Construction Spending, Seasonally Adjusted (in \$millions)	Dec-12	Nov-12	Dec-11	Nov-12	Dec-11
Total Construction	884,980	876,942	820,614	0.9%	7.8%
Residential	314,567	308,233	257,142	2.1%	22.3%
Nonresidential	570,413	568,709	563,473	0.3%	1.2%
Lodging	11,620	11,410	10,009	1.8%	16.1%
Transportation	40,564	41,333	35,602	-1.9%	13.9%
Power	93,821	92,559	84,351	1.4%	11.2%
Office	38,337	37,597	35,135	2.0%	9.1%
Commercial	47,307	47,910	45,695	-1.3%	3.5%
Manufacturing	50,679	49,457	51,031	2.5%	-0.7%
Health care	40,392	39,778	40,859	1.5%	-1.1%
Educational	83,679	83,077	85,576	0.7%	-2.2%
Water supply	12,805	13,215	13,293	-3.1%	-3.7%
Amusement and recreation	15,973	15,829	16,691	0.9%	-4.3%
Highway and street	78,710	78,178	82,350	0.7%	-4.4%
Communication	16,992	17,168	17,897	-1.0%	-5.1%
Conservation and development	5,765	5,563	6,359	3.6%	-9.3%
Religious	3,693	3,639	4,110	1.5%	-10.1%
Public safety	9,344	9,364	10,700	-0.2%	-12.7%
Sewage and waste disposal	20,733	22,635	23,816	-8.4%	-12.9%
Employment, Seasonally Adjusted (in thousands)	Dec-12	Nov-12	Dec-11	Nov-12	Dec-11
National Total Nonfarm	134,668	134,472	132,498	0.1%	1.6%
Construction	5,703	5,673	5,612	0.5%	1.6%
Residential building	574.4	574.2	575.6	0.0%	-0.2%
Nonresidential building	669.0	667.2	655.9	0.3%	2.0%
Heavy and civil engineering construction	883.0	880.2	859.4	0.3%	2.7%
Residential specialty trade contractors	1,501.9	1,489.8	1,461.9	0.8%	2.7%
Nonresidential specialty trade contractors	2,074.6	2,061.6	2,058.9	0.6%	0.8%
Producer Prices	Dec-12	Nov-12	Dec-11	Nov-12	Dec-11
Finished Goods (seasonally adjusted)	NA	NA	NA	-0.2%	1.3%
Inputs to Construction Industries	NA	NA	NA	-0.1%	1.3%
Nonresidential Construction	NA	NA	NA	-0.3%	0.8%
Softwood lumber (not seasonally adjusted)	NA	NA	NA	2.1%	17.3%
Concrete products (seasonally adjusted)	NA	NA	NA	0.6%	2.4%
Crude energy (seasonally adjusted)	NA	NA	NA	7.2%	-4.5%
Iron and steel (not seasonally adjusted)	NA	NA	NA	0.8%	-8.4%

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 1,000 professionals in over 20 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:

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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 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

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