

# MARCUM

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Issue 3  
FIRST QUARTER 2013

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## Nonresidential Construction Recovery Restrained by Public Funding

By Anirban Basu, Chief Construction Economist, Marcum LLP



The U.S. economy outperformed expectations during the first quarter, led by a combination of rising stock prices and household wealth, an improving housing market, steady auto sales and engaged consumers. Admittedly, expectations coming into the quarter were low given increased taxes and what turned out to be legitimate concerns regarding sequestration. According to preliminary estimates, the economy expanded 2.5 percent on an annualized basis during 2013's initial three months, much better than the 0.4 percent annualized growth posted during 2012's final quarter.

Unfortunately, the first quarter ended on a sour note. Job creation slowed in March and factory output fell. Fragile state and local government budgets also continue to plague the economic recovery, and federal sequestration impacts will become more apparent during the second quarter, despite recent modifications made to assuage angry air travelers.

As a result, stakeholders can expect the recovery in nonresidential construction

to remain highly constrained, with rare industry-specific and geographic exceptions. Sequestration is anticipated to result in more than \$4 billion in cuts to ongoing construction programs. Cuts include decreases in Hurricane Sandy relief for the Mid-Atlantic region, \$250 million from Corps of Engineers construction, \$210 million from the EPA water infrastructure program, and a \$856 million cut in military construction spending (\$408 million from the Army; \$297 million from the Navy and Marines, and \$151 million from the Air Force). While \$4 billion in spending cuts translates into only 0.7 percent of total annual nonresidential construction, there will be additional indirect/multiplier effects.

Construction data were unspectacular even before sequestration began to have meaningful effect. In March, nonresidential construction spending fell 2.9 percent on a monthly basis following a 1.2 percent increase in February and a 4.3 percent reduction in January. Spending fell in both private and public categories in March. Private construction spending fell 1.5 percent and public nonresidential construction spending declined 4.5 percent for the

month. Just three out of sixteen nonresidential construction subsectors posted increases in March: communication, up 4.5 percent; religious spending, up 2.0 percent; and lodging, up 1.6 percent. The largest monthly losses were primarily in subsectors associated with public financing: sewage and waste disposal, down 10.4 percent; water supply, down 6.4 percent; conservation and development, down 5.4 percent; and highway and street, down 5.1.

On a year-over-year basis, construction was down 1.2 percent in March. Eleven nonresidential construction sub-sectors have posted losses on a year-over-year basis, including sewage and waste disposal, down 18.8 percent; public safety, down 14.3 percent; and amusement and recreation, down 12.9 percent. Those subsectors posting the largest increases in spending include transportation, up 19.1 percent; lodging, up 11.6 percent; and power, up 4.3 percent. Exhibit 1 reflects the fact that neither public nor private construction has exhibited significant upward momentum of late. In fact, the year-over-year comparisons deteriorated in March for both categories.

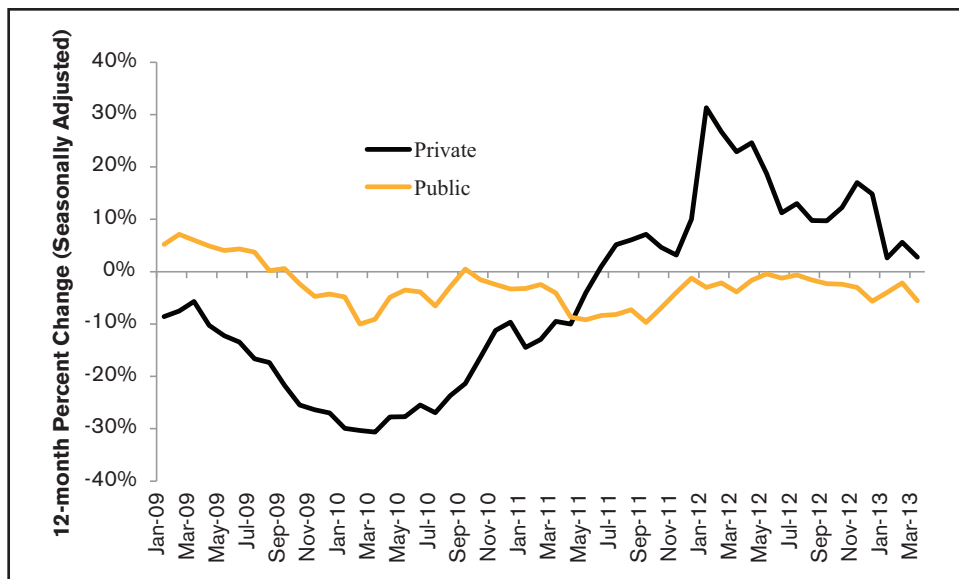
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Looking back at the past three months, it seems we continue on the path of a slow but meaningful recovery within the construction sector. I note a cautious but continued optimism among my construction contractor clients and my peers in professional services. My sources and the data provided in this quarter's index talk of even more significant activity in the subspecialty of transportation, as well as general upticks in many of our major urban markets around the country. While the industrialized centers of the country like Detroit, St. Louis and Chicago continue to suffer, 14 of the country's 20 largest metropolitan areas saw growth in construction employment in the past year, and two – Baltimore and Dallas-Ft. Worth – were in the double-digits. Just in the areas I visit regularly during a typical work week, we have the \$3 billion-plus replacement of the Tappan Zee Bridge, a \$2-\$2.5 billion dollar road and bridge repair proposal in Pennsylvania, and a massive mixed-use conversion project planned in Brooklyn, NY. Those are just some of the very large jobs in my own immediate area and clearly don't take into consideration the great things starting to happen in other regions such as San Francisco, Phoenix, or Tampa-St. Pete, to name a few.

Times may not be getting better as quickly as we'd like, but, thanks to indices and other research like ours in your industry, the hard data is out there, showing signs of improvement. Let's stick to these facts and build upon these successes.

**Joseph Natarelli, CPA**  
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▼ **Exhibit 1.** *Nonresidential Construction Spending*  
 January 2009 through March 2013



Source: Census Bureau

This is not to suggest that there are not areas of concentrated activity. One area of focus is transportation, with many states finding ways to finance new initiatives by raising taxes, entering into public-private partnerships or through other means. As an example, the Pennsylvania Senate recently proposed \$2.5 billion in spending through 2018 to repair roads and bridges and support railways, airports, ports, bicycle and pedestrian programs. The Tappan Zee Bridge replacement project in New York, valued at \$3.14 billion, is anticipated to be completed in 2018 with the first span expected to open in 2016. Maryland increased taxes on gasoline, which should raise \$4.4 billion in transportation funding over six years. On the other hand, in Wisconsin, budgetary pressures have forced Governor Walker to propose delaying major transportation projects to address a projected \$63.4 million gap in the state's road fund through 2015.

In terms of private investment, several major mixed-use developments have emerged in recent months. In Brooklyn, New York, developers are hoping to break ground on a \$1.5 billion mixed-use development on the old Domino Sugar site in 2014. The development will feature 79,000-square feet in retail space and nearly 2,300 apartments. In Oakland, California, developers released plans for a \$1.5 billion project to revitalize 645 acres of industrial land situated along the waterfront. That development would consist of 3,100 homes and 200,000-square feet of retail space. Developers hope to complete the project in 2021.

Thanks in part to the rebound in housing construction (housing starts have returned to the million mark on an annualized basis), construction industry employment as of March was up 2.8 percent over the past year. However, the industry's unemployment rate remains well into the double-digits. Much of the recent job growth has been among residential specialty trade contractors, a group that was devastated by the housing downturn that began circa 2006.

Among the 20 largest metropolitan areas, 14 have experienced construction employment creation over the past year. The Baltimore metropolitan area, a region of 2.7 million people, experienced the largest increase in employment (11.5%). Many of the regions shedding jobs were in the industrial Midwest, including Detroit, down 8.2 percent; St. Louis, down 1.3 percent; and Chicago, down 0.8 percent.

▼ **Exhibit 2.** *Construction Employment Growth in 20 Largest U.S. Metropolitan Areas March 2013 v. March 2012, Not Seasonally Adjusted*

| Rank | MSA   | Change |
|------|---|--------|
| 1    | Baltimore-Towson, MD*                               | 11.5%  |
| 2    | Dallas-Fort Worth-Arlington, TX*                    | 11.4%  |
| 3    | San Francisco-Oakland-Fremont, CA                   | 9.8%   |
| 4    | Phoenix-Mesa-Glendale, AZ                           | 8.2%   |
| 5    | Los Angeles-Long Beach-Santa Ana, CA                | 6.3%   |
| 6    | Tampa-St. Petersburg-Clearwater, FL                 | 5.5%   |
| 7    | Miami-Fort Lauderdale-Pompano Beach, FL             | 4.9%   |
| 8    | Houston-Sugar Land, TX                              | 4.8%   |
| 9    | Boston-Cambridge-Quincy, MA-NH                      | 4.6%   |
| 10   | Seattle-Tacoma-Bellevue, WA                         | 3.9%   |
| 11   | Atlanta-Marietta, GA                                | 2.8%   |
| 12   | San Diego-Carlsbad-San Marcos, CA                   | 2.7%   |
| 13   | Washington-Arlington-Alexandria, DC-VA-MD-WV*       | 1.6%   |
| 14   | New York-Northern New Jersey-Long Island, NY-NJ-PA* | 0.7%   |
| 15   | Minneapolis-St. Paul-Bloomington, MN-WI*            | -0.2%  |
| 16   | Philadelphia-Camden-Wilmington, PA-NJ-DE-MD*        | -0.7%  |
| 17   | Chicago-Joliet-Naperville, IL-IN-WI                 | -0.8%  |
| 18   | St. Louis, MO-IL*                                   | -1.3%  |
| 19   | Riverside-San Bernardino-Ontario, CA                | -1.9%  |
| 20   | Detroit-Warren-Livonia, MI*                         | -8.2%  |

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

One of the better aspects of construction industry performance over the past year has been in terms of stable materials prices. In prior years, materials prices have been highly volatile, largely following the whims of commodity traders. But over the past year, materials prices have been generally well behaved. March 2013 input prices to the construction industry were up just 0.9 percent on a year-over-year basis, despite a 30 percent rise in softwood lumber prices and increases in other residentially oriented construction materials as well. That said, prices have become a bit more volatile of late, including iron and steel prices, which rose 1.4 percent in March on a monthly basis.

For now, economic recovery remains in place. Various leading indicators such as the Architecture Billings Index remain in positive territory, implying nonresidential construction spending growth during the latter stages of 2013 and into 2014. Many projects are in planning stages across many segments. However, the next several months are likely to be softer from a growth perspective than January and February, and the construction leading indicators have on occasion proven too optimistic. For now, stakeholders should keep an eye on Federal Reserve policy, the actual impacts of sequestration, and the willingness of consumers to spend, including on housing.

| <b>First Quarter 2013 Performance</b>                             | <b>Quarterly Values</b> |               |               | <b>% Change from</b> |               |
|---|-------------------------|---------------|---------------|----------------------|---------------|
| <b>Gross Domestic Product</b>                                     | <b>2013Q1</b>           | <b>2012Q4</b> | <b>2012Q1</b> | <b>2012Q4</b>        | <b>2012Q1</b> |
| Overall Real GDP  | 2.5%                    | 0.4%          | 2.0%          | NA                   | NA            |
| Nonresidential Fixed Investment in Structures                     | -0.3%                   | 16.7%         | 12.9%         | NA                   | NA            |
| <b>Construction Spending, Seasonally Adjusted (in \$millions)</b> | <b>Mar-13</b>           | <b>Feb-13</b> | <b>Mar-12</b> | <b>Feb-13</b>        | <b>Mar-12</b> |
| Total Construction  | 856,719                 | 871,231       | 817,842       | -1.7%                | 4.8%          |
| Residential   | 301,638                 | 299,662       | 256,156       | 0.7%                 | 17.8%         |
| Nonresidential  | 555,080                 | 571,569       | 561,686       | -2.9%                | -1.2%         |
| Transportation  | 39,045                  | 39,704        | 32,793        | -1.7%                | 19.1%         |
| Lodging   | 12,414                  | 12,220        | 11,122        | 1.6%                 | 11.6%         |
| Power   | 98,202                  | 100,976       | 94,195        | -2.7%                | 4.3%          |
| Manufacturing   | 49,411                  | 50,026        | 47,791        | -1.2%                | 3.4%          |
| Office  | 36,800                  | 37,548        | 35,780        | -2.0%                | 2.9%          |
| Commercial  | 46,365                  | 47,715        | 46,425        | -2.8%                | -0.1%         |
| Healthcare  | 39,308                  | 40,101        | 40,154        | -2.0%                | -2.1%         |
| Communication   | 16,302                  | 15,597        | 17,008        | 4.5%                 | -4.2%         |
| Religious   | 3,846                   | 3,769         | 4,019         | 2.0%                 | -4.3%         |
| Highway and street  | 73,905                  | 77,896        | 77,797        | -5.1%                | -5.0%         |
| Water supply  | 12,686                  | 13,549        | 13,446        | -6.4%                | -5.7%         |
| Educational   | 79,665                  | 82,177        | 85,520        | -3.1%                | -6.8%         |
| Conservation and development                                      | 5,682                   | 6,004         | 6,323         | -5.4%                | -10.1%        |
| Amusement and recreation  | 13,783                  | 13,891        | 15,820        | -0.8%                | -12.9%        |
| Public safety   | 9,064                   | 9,636         | 10,577        | -5.9%                | -14.3%        |
| Sewage and waste disposal   | 18,604                  | 20,761        | 22,915        | -10.4%               | -18.8%        |
| <b>Employment, Seasonally Adjusted (in thousands)</b>             | <b>Apr-13</b>           | <b>Mar-13</b> | <b>Apr-12</b> | <b>Mar-13</b>        | <b>Apr-12</b> |
| National Total Nonfarm  | 134,474                 | 135,309       | 133,397       | 0.1%                 | 1.6%          |
| Construction  | 5,790                   | 5,796         | 5,636         | -0.1%                | 2.7%          |
| Residential building  | 586.4                   | 580.2         | 572.0         | 1.1%                 | 2.5%          |
| Nonresidential building   | 677.4                   | 682.2         | 659.7         | -0.7%                | 2.7%          |
| Heavy and civil engineering construction                          | 883.3                   | 887.1         | 869.9         | -0.4%                | 1.5%          |
| Residential specialty trade contractors                           | 1,545.4                 | 1,538.3       | 1,476.1       | 0.5%                 | 4.7%          |
| Nonresidential specialty trade contractors                        | 2,097.2                 | 2,108.3       | 2,058.2       | -0.5%                | 1.9%          |
| <b>Producer Prices</b>  | <b>Mar-13</b>           | <b>Feb-13</b> | <b>Mar-12</b> | <b>Feb-13</b>        | <b>Mar-12</b> |
| Finished Goods (seasonally adjusted)                              | NA                      | NA            | NA            | -0.6%                | 1.1%          |
| Inputs to Construction Industries                                 | NA                      | NA            | NA            | -0.0%                | 0.9%          |
| Nonresidential Construction                                       | NA                      | NA            | NA            | -0.2%                | 0.2%          |
| Softwood lumber (not seasonally adjusted)                         | NA                      | NA            | NA            | 4.4%                 | 30.1%         |
| Concrete products (seasonally adjusted)                           | NA                      | NA            | NA            | 0.1%                 | 2.1%          |
| Crude energy (seasonally adjusted)                                | NA                      | NA            | NA            | -8.5%                | -1.9%         |
| Iron and steel (not seasonally adjusted)                          | NA                      | NA            | NA            | 1.4%                 | -9.4%         |

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 1,100 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.

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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
- ▶ Public Company Filings
- ▶ Strategic and Operational Planning

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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.

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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

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

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#### **Forensic and Litigation Services**

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- ▶ Damage Determination and Expert Testimony
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- ▶ 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

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### ▼ Anirban Basu

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