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IN THIS ISSUE

Economic Recovery Enters Mid-Cycle Phase

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Expect Rising Wages, Higher Interest Rates and Solid Demand

The nonresidential construction recovery can now be considered a vigorous one, particularly relative to the balance of the economy. According to an August 3 release supplied by the U.S. Census Bureau, nonresidential construction spending was unchanged on a month-over-month basis in June, totaling $686.9 billion on a seasonally adjusted, annualized rate. Despite the lack of month-over-month growth, nonresidential spending is 11.5 percent higher than it was at the same time one year ago and expanded 9.8 percent during the year's first six months, the fastest such growth since the Census Bureau began tracking construction spending in 2002.

Nonresidential construction would have reached historic highs this year were it not for stagnation in the power spending category, which is the largest of the 16 subsectors that comprise the industry. Power-related spending fell 16.5 percent over the past 12 months and is one of only two subsectors that haven't experienced growth on a year-over-year basis. The intuitive explanation is that since energy prices have plummeted, there is less interest in adding power-related capacity. However, because spending in this segment was elevated during the first half of 2014, the year-to-year comparison is a bit skewed. It is quite likely that the power segment's year-over-year performance will improve during the second half of 2015.

Eight of 16 nonresidential construction sectors experienced spending increases in June on a monthly basis:

- Lodging-related construction spending was up 3.9 percent on a monthly basis and 42.2 percent on a year-over-year basis.
- Spending in the water supply category expanded 12.2 percent from May and is up 12 percent on an annual basis.
- Highway and street-related construction spending expanded 1.3 percent in June and is up 14.8 percent compared to the same time last year.
- Amusement and recreation-related construction spending was up 10.2 percent on a monthly basis and is up 39.2 percent from the same time last year.
- Communication-related construction spending fell 6.8 percent for the month, but is up 13.4 percent for the year.
- Construction spending in the transportation category grew 2.3 percent on a monthly basis and has expanded 9.6 percent on an annual basis.
- Sewage and waste disposal-related construction spending grew 1.6 percent for the month and expanded 5.3 percent on a 12-month basis.
- Public safety-related construction spending grew 2.5 percent on a monthly basis, but is down 3.1 percent on a year-over-year basis.

Spending in the remaining eight nonresidential construction subsectors fell in June on a monthly basis:

- Education-related construction spending fell 0.2 percent for the month, but is up 2.1 percent on a year-over-year basis.
- Power-related construction spending fell 0.9 percent for the month and has declined 16.5 percent for the year, the most of any nonresidential category.
- Commercial construction spending fell 4.3 percent in June, but is up 7.6 percent on a year-over-year basis.
- Health care-related construction spending fell 0.9 percent for the month, but is up 6.3 percent for the year.
- Manufacturing-related construction spending fell 0.8 percent in June, but is up by 62.1 percent for the year.
- Office-related construction spending fell 1.1 percent in June, but is up 24.4 percent from the same time one year ago.
- Conservation and development-related construction spending fell 5.8 percent for the month, but is up 6.5 percent on a yearly basis.
- Religious spending fell 6.2 percent for the month, but is up 5 percent from the same time last year.

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Joe's View

A RISING TIDE

More than a half-decade into our nationwide economic recovery, the tide has truly reached our shores. Our past indices have shown a health and/or vigor in most sectors, but this one, I'm happy to say, tells a great story throughout. Both the public and private nonresidential sectors are humming along and are demonstrating meaningful, sometimes record, gains (year-over-year).

I've been touting our return to business-as-usual and profitability for a while now. I am, by nature, an optimist and at least in this case, rightly so, but I do want to mix a little reality into this celebration. As the demands for commercial construction grow, our resources become taxed. So, scarcity ought to be a threat on which we keep watch. As noted in the index, key support industries of ours (e.g. trucking, labor) are already showing signs of stress, and there will be more if we allow all of this to boil over.

How do we manage our growth and make it sustainable? I'm not an economist (although I know a great one who writes an index), so I'll offer an idea that I think we all already know. We, the members and beneficiaries of the great American construction trade, should do what we can to nurture the development of skilled labor. In my office, I'm often heard to say that Marcum's greatest asset goes home, every night. I believe the same is true on the job site, on the roads and highways, at the drafting tables and at the docks. Let's invest in all of our futures by making sure that young people can learn the skills that will be required to sustain growth and to have their own successes, in the future.

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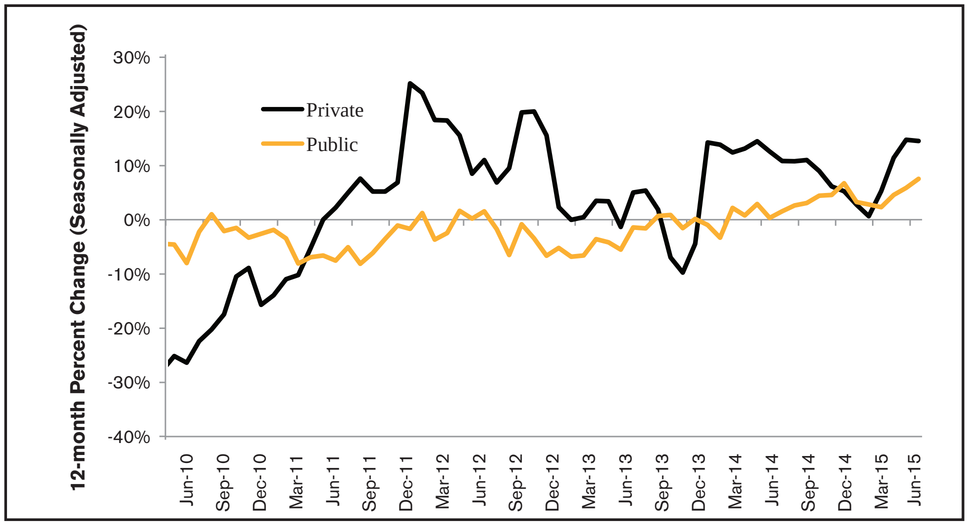
Graph

Exhibit 1 reflects the current year's acceleration in nonresidential spending growth. The public sector, which has been a drag on the nonresidential spending recovery, is finally showing meaningful expansion led by highway/street, water, and waste disposal. Aggregate public nonresidential construction spending experienced its most rapid year-over-year growth since the recovery began in June, increasing 7.6 percent. The fact that public nonresidential spending has increased by at least 4.5 percent on a yearly basis during each of the last three months for which data are available serves as further reason to be optimistic about the second half of 2015.

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



Source: Census Bureau

But the most compelling reason to be optimistic regarding industry prospects lies in the performance of the broader U.S. economy. If the economic recovery were likened to a college basketball game, we would now be in the early to mid-stage of the second half. With the arrival of mid-June, the nation completed its sixth year of economic recovery and has entered its seventh.

Once upon a time, people would have been right to fret that the end of the recovery was fast approaching. The average duration of economic expansions between 1860 and 1945 was just 26 months. The average post-World War II recovery has lasted about 58 months, or slightly more than 4.5 years. However, the most recent three economic recoveries lasted an average of 95 months, or nearly eight years. Recoveries have been getting longer, and it is therefore conceivable that the current economic expansion will end up surpassing the previous record of precisely 10 years.

It took us a long time to arrive at the mid-phase of the recovery. This is typically the lengthiest phase of recovery and ultimately gives way to the late phase when the economy overheats. Already, signs of overheating are emerging, particularly with respect to oncoming skills shortages in key industry categories like trucking and construction. Despite that, average hourly earnings are up only 2 percent over the past year nationally, well below the Federal Reserve's national goal of 3.5 percent. The nation added another 223,000 net new jobs in June (preliminary estimate) and has added nearly 3 million positions over the past year, but that plus increases in minimum wages in certain parts of the nation have not been enough to trigger rapid overall wage growth.

Eventually, the Federal Reserve will have to respond to emerging inflationary pressures. Many analysts continue to believe that the Federal Reserve will begin to raise short-term interest rates later this year not simply to preempt potential inflation, but also to reduce prospects for additional capital market distortions. The Federal Reserve has maintained ultra-low short-term rates for many years, prompting concerns that investments in bond and other asset markets have become unbalanced.

Though the official rate of unemployment is now low enough to justify higher rates, the nation's labor force participation rate stands at a multi-decade low. In June, the nation's labor force participation rate dipped to 62.6 percent, the lowest rate since October 1977. While much of this is attributable to retiring Baby Boomers, according to Bureau of Labor Statistics data, one in five (22 percent) of those who left the labor force in June were between 25 and 34 years old, a sign of discouragement among younger workers, many of whom recently graduated from school. Interestingly, 93 percent (402,000) of all leavers were men.

U.S. construction industry employment was effectively unchanged in June according to the Bureau of Labor Statistics' preliminary estimate released July 2, 2015. Prior to June, construction employment had registered two consecutive months of meaningful gains. Over the past year, construction has averaged 21,000 net new jobs per month, so June represented a somewhat surprising pause in momentum. One possible reason for this performance may be that construction firms simply can't easily secure additional workers at current wage rates. The construction unemployment rate fell four-tenths of a percentage point to 6.3 percent in June.

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

Rank	MSA	Percent Change
1	Seattle-Tacoma-Bellevue, WA	15.5%
2	Detroit-Warren-Dearborn, MI*	15.3%
3	Riverside-San Bernardino-Ontario, CA	7.6%
4	Los Angeles-Long Beach-Anaheim, CA	7.1%
4	Philadelphia-Camden-Wilmington, PA-NJ-DE-MD*	7.1%
6	Phoenix-Mesa-Scottsdale, AZ	6.1%
7	San Diego-Carlsbad, CA	5.7%
8	Boston-Cambridge-Nashua, MA-NH*	5.3%
9	Miami-Fort Lauderdale-West Palm Beach, FL	4.9%
9	New York-Newark-Jersey City, NY-NJ-PA*	4.9%
11	Atlanta-Sandy Springs-Roswell, GA	4.4%
12	Baltimore-Columbia Towson, MD*	4.1%
13	San Francisco-Oakland-Hayward, CA	3.7%
14	Minneapolis-St. Paul-Bloomington, MN-WI*	3.3%
15	Chicago-Naperville-Elgin, IL-IN-WI	3.1%
16	Tampa-St. Petersburg-Clearwater, FL	1.5%
17	Dallas-Fort Worth-Arlington, TX*	1.3%
18	Houston-The Woodlands-Sugar Land, TX	1.2%
19	Washington-Arlington-Alexandria, DC-VA-MD-WV*	0.8%
20	St. Louis, MO-IL*	0.3%

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

Looking Ahead

Perhaps the most remarkable and unanticipated aspect of today's economy is the prevalence of extremely low energy prices. Over the past year, the impact of these low prices has been largely negative with the energy-related boom in physical investment softening significantly in recent months. The next few months will see the other shoe drop. Low energy prices have helped to support profitability in many other segments of the economy, which appears to be fueling investment in manufacturing and other sectors for which energy is a major source of cost. Recent readings from the Institute for Management indicate a looming pickup in industrial production.

Consumers continue to represent the most critical driver of economic expansion. That won't change. The combination of low energy prices, falling unemployment and rising wages should help support ongoing economic expansion and continued momentum in the nation's nonresidential construction industry.

Second Quarter 2015 Performance	Quarterly Values			% Change from	
Gross Domestic Product	**2015Q2**	**2015Q1**	**2014Q4**		
Overall Real GDP	2.3%	0.6%	2.1%	NA	NA
Nonresidential Fixed Investment in Structures	-1.6%	-7.4%	4.3%	NA	NA
Construction Spending, Seasonally Adjusted (in $millions)	**Jun-15**	**May-15**	**Jun-14**	**May-15**	**Jun-14**
Total Construction	1,064,594	1,063,492	950,282	0.1%	12.0%
Residential	377,985	376,666	334,459	0.4%	13.0%
Nonresidential	686,609	686,825	615,823	0.0%	11.5%
Lodging	22,036	21,214	15,501	3.9%	42.2%
Office	55,442	56,084	44,555	-1.1%	24.4%
Commercial	65,054	67,964	60,483	-4.3%	7.6%
Healthcare	40,374	40,758	37,973	-0.9%	6.3%
Educational	83,843	84,052	82,105	-0.2%	2.1%
Religious	3,376	3,600	3,214	-6.2%	5.0%
Public safety	9,051	8,830	9,340	2.5%	-3.1%
Amusement and recreation	23,324	21,169	16,757	10.2%	39.2%
Transportation	46,882	45,849	42,794	2.3%	9.6%
Communication	18,768	20,133	16,547	-6.8%	13.4%
Power	88,476	89,256	105,928	-0.9%	-16.5%
Highway and street	91,535	90,343	79,707	1.3%	14.8%
Sewage and waste disposal	26,207	25,801	24,890	1.6%	5.3%
Water supply	15,104	13,460	13,484	12.2%	12.0%
Conservation and development	8,104	8,604	7,606	-5.8%	6.5%
Manufacturing	89,033	89,711	54,939	-0.8%	62.1%
Employment, Seasonally Adjusted (in thousands)	**Jun-15**	**May-15**	**Jun-14**	**May-15**	**Jun-14**
National Total Nonfarm	141,842	141,619	138,907	0.2%	2.1%
Construction	6,380.0	6,380.0	6,121.0	0.0%	4.2%
Residential building	686.3	692.4	656.7	-0.9%	4.5%
Nonresidential building	721.7	717.2	696.8	0.6%	3.6%
Heavy and civil engineering construction	946.0	942.2	915.6	0.4%	3.3%
Residential specialty trade contractors	1,755.4	1,751.7	1,658.0	0.2%	5.9%
Nonresidential specialty trade contractors	2,270.5	2,276.1	2,194.0	-0.2%	3.5%
Producer Prices	**Jun-15**	**May-15**	**Jun-14**	**May-15**	**Jun-14**
Finished Goods (seasonally adjusted)	196.9	192.5	201.9	0.9%	-2.5%
Inputs to Construction Industries	212.5	214.7	221.4	0.2%	-2.8%
Softwood lumber (seasonally adjusted)	191.4	184.7	204.1	3.6%	-6.2%
Concrete products (seasonally adjusted)	239.2	239.4	229.6	-0.1%	4.2%
Crude energy materials (seasonally adjusted)	160.7	157.3	251.0	2.2%	-36.0%
Iron and steel (not seasonally adjusted)	200.2	198.6	232.6	0.8%	-13.9%

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

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- Financial Audits Reviews and Compilations
- Breakeven Analyses
- Single Audits
- Sarbanes-Oxley 404 Compliance
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- Internal Control Reviews
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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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- Damage Determination and Expert Testimony
- Marital Dissolution
- Regulatory Compliance, including Bank Secrecy Act and Taxation
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- 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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