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Commercial Construction ▶

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Industry Activity is Stable to Start 2016

By Anirban Basu, Chief Construction Economist, Marcum LLP

Spending Fares Better than Employment

Nonresidential construction spending shrank 0.4 percent on a monthly basis in March, though March would have been associated with a nonresidential spending gain were it not for significant upward revisions to February's data. Nonresidential spending totaled \$695.7 billion in March on a seasonally adjusted, annualized basis and is up 8.3 percent from March 2015. Much of that growth is associated with the spring and early summer of 2015. Spending growth has stagnated in more recent months.

Precisely half of the 16 nonresidential subsectors experienced monthly growth in March. Twelve experienced year-over-year gains. Three of the four nonresidential construction segments experiencing year-over-year spending declines—water supply, conservation and development, and public safety—rank among the four smallest subsectors and are largely dependent on public sector budgets. **Exhibit 1** supplies relevant statistical detail.

▼ **Exhibit 1.** Nonresidential Spending, March 2016, Millions of Dollars, Seasonally Adjusted Annual Rate

Subsector	March 2016	1-month % Change	12-month % Change
Nonresidential	695,714	-0.4%	8.3%
Lodging	23,660	1.0%	27.7%
Office	62,585	-1.3%	19.5%
Commercial	73,773	1.2%	14.5%
Health care	40,918	1.6%	4.1%
Educational	88,734	-0.6%	11.8%
Religious	3,360	5.2%	6.4%
Public safety	7,633	-7.8%	-12.3%
Amusement and recreation	21,037	-1.0%	9.6%
Transportation	44,969	-2.1%	1.2%
Communication	19,096	3.7%	10.4%
Power	86,938	-3.2%	0.8%
Highway and street	97,615	0.5%	18.8%
Sewage and waste disposal	25,866	-4.2%	3.8%
Water supply	12,187	-1.6%	-6.1%
Conservation and development	7,437	1.6%	-3.3%
Manufacturing	79,905	2.0%	-2.1%

Source: U.S. Census Bureau

Spring has sprung on the East Coast but, as we look back on the first quarter of 2016, it seems the winds of change blew hot and cold across our marketplace. Year over year, we are seeing growth in non-residential construction spending, as a whole. Half of the 16 construction subsectors are up February-to-March 2016, and three-quarters are up with year-over-year growth. Not a bad way to start the year, and while we didn't have a hard freeze this winter, sunnier and busier days surely lay ahead for construction contractors, nonetheless. In fact, we're told by many non-residential construction firms that they maintain big backlogs, still.

While our data did offer quite a bit of encouraging good news, it wasn't all rainbows in all areas. Certain sectors, such as Public Safety, Water Supply and others, did actually take a turn, downwards. We'll be keeping an eye on them over the course of the next few indices, but it is worth noting that all of the subsectors in decline are controlled largely by governmental spending and are driven more by policy and politics than by prevailing market forces. Additionally, the four year-over-year losers were also the four smallest specialties.

Whether on the job site, at the little league field or on the beach, I hope you enjoy some sunshine on your face in the coming months as well as a productive and profitable 2Q of 2016.

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

Peeking back just a dozen years, it is possible to see enormous shifts in the composition of nonresidential construction spending. No sector looks as different as manufacturing. While it may difficult to believe, official data from the Bureau of Economic Analysis indicates that spending on manufacturing-related construction is currently more than six times higher than it was in 2004. Back then, major U.S. auto producers were striving to avoid bankruptcy. Today, these companies have become profitable and expanded their respective global footprints. Foreign auto manufacturers have often chosen to expand production in North America, including companies like Subaru, Toyota, BMW, Mercedes, and VW. Tesla's \$5 billion Gigafactory began construction in mid-2015 in Sparks, Nevada. That project alone would have accounted for nearly half of the manufacturing-related construction spending generated in calendar year 2004. Boeing's expansion has added to sectoral momentum.

Not surprisingly, the power sector has also been associated with large construction spending increases over the past 12 years. Between 2004 and 2016, the annualized rate of spending climbed from around \$36 billion to nearly \$87 billion. Spending has stagnated more recently, but the nation's rate of investment in power plants and related facilities remains far higher than it was pre-recession.

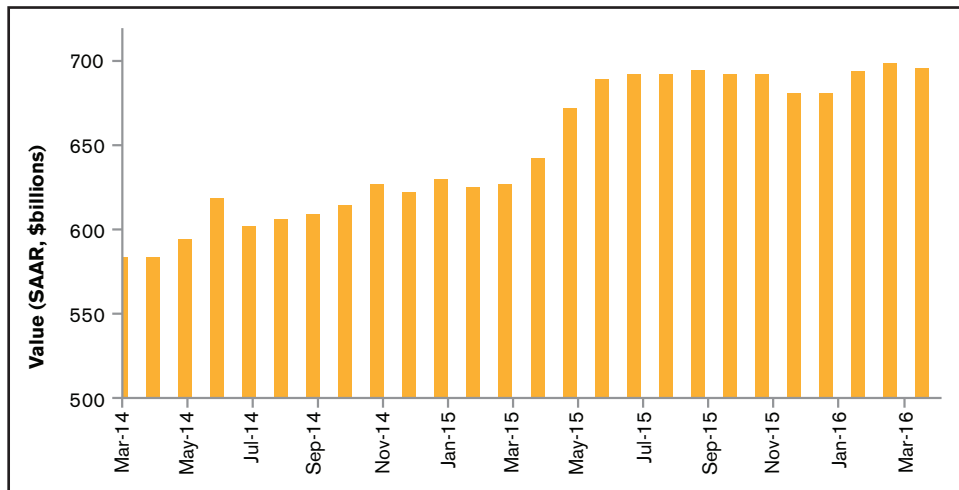
Only two nonresidential construction spending subsectors—religious and public safety—have experienced decline over the past dozen years. The pace of public safety-related spending, which encompasses police and fire stations, prisons and jails, declined by nearly 3 percent between 2004 and 2016 based on March data. Religious-related spending (e.g., churches, temples, synagogues, mosques) has fallen by more than 55 percent over this period. The impact on overall nonresidential construction spending related to these categories is small, however. These two sectors jointly account for a bit more than 1.5 percent of total nonresidential spending. As Exhibit 2 indicates, nonresidential construction spending surged during the first and second quarters of 2015, but has established a much flatter trajectory since then. Other construction indicators are consistent with the notion that industry growth has slowed.

Employment Growth Slows on Residential Weakness

The entire U.S. construction industry (residential and nonresidential) added only 1,000 net new jobs in April according to the May 6 release supplied by the U.S. Bureau of Labor Statistics. Residential specialty trade contractors were primarily to blame for the poor showing. That subsector shed 10,900 positions on net in March. The heavy and civil engineering sector lost 2,200 positions. Nonresidential employment—encompassing both the nonresidential specialty trade contractor and business subsectors—expanded by 6,600 net new jobs in April and is up by 102,200 positions on a year-over-year basis.

Were these subpar data released earlier in the year, it would have been reasonable to suspect that meteorological conditions were to blame for soft employment growth. By April, it becomes more difficult to attribute economic outcomes to the weather. It is possible that activity related to the nation's multifamily rental market has begun to slow in the face of growing concerns regarding an emerging excess of apartments in a number of key markets.

▼ **Exhibit 2.** Nonresidential Construction Spending, March 2014 through March 2016



Source: U.S. Census Bureau

Regional construction employment growth dynamics have changed drastically over the past 12 months. A year ago, Detroit was leading the nation's 20 largest metropolitan areas in terms of construction employment growth. Today, it ranks 16th. Tampa Bay is the new national leader, with the number of construction jobs there growing by nearly 11 percent between March 2015 and March 2016. Houston and Dallas now rank 19th and 20th, respectively. For a number of years, these two massive Texas markets were at the vanguard of construction employment creation, but of course that was when oil and natural gas prices were much higher.

▼ **Exhibit 3.** *Construction Employment Growth in 20 Largest U.S. Metropolitan Areas
March 2015 v. March 2016, Not Seasonally Adjusted*

Rank	MSA	Percent Change	Rank	MSA	Percent Change
1	Tampa-St. Petersburg-Clearwater, FL	10.70%	11	Philadelphia-Camden-Wilmington, PA-NJ-DE-MD*	6.90%
2	Boston-Cambridge-Quincy, MA-NH	9.70%	12	Seattle-Tacoma-Bellevue, WA	6.10%
3	Phoenix-Mesa-Glendale, AZ	8.50%	12	Baltimore-Towson, MD*	6.10%
4	Miami-Fort Lauderdale-Pompano Beach, FL	8.30%	14	San Diego-Carlsbad-San Marcos, CA	6.00%
5	S.Franisco-Oakland-Fremont, CA	8.20%	15	Chicago-Joliet-Naperville, IL-IN-WI	5.20%
6	Atlanta-Marietta, GA	8.10%	16	Detroit-Warren-Livonia, MI*	3.30%
7	Riverside-San Bernardino-Ontario, CA	8.00%	17	Minneapolis-St. Paul-Bloomington, MN-WI*	2.60%
8	Washington-Arlington-Alexandria, DC-VA-MD-WV*	7.70%	18	St. Louis, MO-IL	1.60%
9	Los Angeles-L.Beach-Santa Ana, CA	7.60%	19	Houston-Sugar Land, TX	1.30%
9	New York-Northern New Jersey-L. Island, NY-NJ-PA*	7.60%	20	Dallas-Fort Worth-Arlington, TX*	0.70%

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

Looking Ahead

Many nonresidential construction firms continue to report lengthy backlog. With the U.S. economy continuing to expand and generate job growth, and with the cost of capital remaining shockingly low, contractors are likely to remain busy over the near- and middle-terms.

As always, there are reasons for concern. The global economy remains weak and deflationary forces are abundant. Business investment in the U.S. continues to be soft, and many state and local governments remain fiscally constrained and cautious. Only the consumer is really contributing to U.S. economic growth, including by taking on more debt.

With the nation grinding toward full employment, wage and inflation pressures have become a bit more apparent. Should that continue, the Federal Reserve may find that it needs to raise interest rates more quickly next year than presently anticipated. That would have many implications, including diminishing both private and public sector construction spending, all things being equal.

SAVE THE DATE

**2016 Marcum
Construction Summit**
September 1 - South Florida
September 27 - New England

**2016 Global
Construction Summit**
October 11 - New York City



First Quarter 2016 Performance	Quarterly Values			% Change from	
Gross Domestic Product	2016Q1	2015Q4	2015Q3		
Overall Real GDP	0.5%	1.4%	2.0%	NA	NA
Nonresidential Fixed Investment in Structures	-5.9%	-2.1%	2.6%	NA	NA
Construction Spending, Seasonally Adjusted (in \$millions)	Mar-16	Feb-16	Mar-15	Feb-16	Mar-15
Total Construction	1,137,488	1,133,627	1,052,899	0.3%	8.0%
Residential	441,774	435,276	410,428	1.5%	7.6%
Nonresidential	695,714	698,352	642,472	-0.4%	8.3%
Lodging	23,660	23,431	18,527	1.0%	27.7%
Office	62,585	63,416	52,368	-1.3%	19.5%
Commercial	73,773	72,917	64,441	1.2%	14.5%
Health care	40,918	40,263	39,312	1.6%	4.1%
Educational	88,734	89,263	79,387	-0.6%	11.8%
Religious	3,360	3,194	3,158	5.2%	6.4%
Public safety	7,633	8,280	8,704	-7.8%	-12.3%
Amusement and recreation	21,037	21,251	19,192	-1.0%	9.6%
Transportation	44,969	45,952	44,457	-2.1%	1.2%
Communication	19,096	18,412	17,299	3.7%	10.4%
Power	86,938	89,795	86,261	-3.2%	0.8%
Highway and street	97,615	97,156	82,150	0.5%	18.8%
Sewage and waste disposal	25,866	27,008	24,931	-4.2%	3.8%
Water supply	12,187	12,386	12,984	-1.6%	-6.1%
Conservation and development	7,437	7,319	7,692	1.6%	-3.3%
Manufacturing	79,905	78,309	81,610	2.0%	-2.1%
Employment, Seasonally Adjusted (in thousands)	Apr-16	Mar-16	Apr-15	Mar-16	Apr-15
National Total Nonfarm	143,915.0	143,755.0	141,223.0	0.1%	1.9%
Construction	6,670.0	6,669.0	6,409.0	0.0%	4.1%
Residential building	727.6	720.5	690.1	1.0%	5.4%
Nonresidential building	747.0	745.9	721.5	0.1%	3.5%
Heavy and civil engineering construction	948.7	950.9	930.8	-0.2%	1.9%
Residential specialty trade contractors	1862.3	1,873.2	1,759.0	-0.6%	5.9%
Nonresidential specialty trade contractors	2,384.1	2,378.6	2,307.4	0.2%	3.3%
Producer Prices	Mar-16	Feb-16	Mar-15	Feb-16	Mar-15
Finished Goods (seasonally adjusted)	106.4	106.2	109.2	0.2%	-2.6%
Inputs to Construction Industries	205.0	203.2	212.3	0.9%	-3.4%
Softwood lumber (seasonally adjusted)	192.5	187.2	195.7	2.8%	-1.6%
Concrete products (seasonally adjusted)	244.7	242.8	237.5	0.8%	3.0%
Unprocessed energy materials (seasonally adjusted)	109.7	103.4	144.5	6.1%	-24.1%
Iron and steel (not seasonally adjusted)	175.0	172.3	205.2	1.6%	-14.7%

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, with offices in major business markets throughout the U.S., Grand Cayman and China. Headquartered in New York City, Marcum provides a full spectrum of traditional tax, accounting and assurance services; advisory, valuation and litigation support; and an extensive range of specialty and niche industry practices. The Firm serves both privately held and publicly traded companies, as well as high net worth individuals, private equity and hedge funds, with a focus on middle-market companies and closely held family businesses. Marcum is a member of the Marcum Group, an organization providing a comprehensive array of professional services.

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- ▶ 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 more than 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.



▼ Anirban Basu

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