

# MARCUM Commercial Construction ▶ Index

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### Another Period of Rapid Spending Growth May be Forthcoming

The job of an economic forecaster is treacherous. *Expect the unexpected* is a common phrase, but until something truly unexpected occurs, one has a tendency to be cocooned in a set of preconceived notions. For many months, there was the broadly shared view that significant change was not coming to Washington, D.C.. Well, that conventional wisdom has been shattered and, with it, the pre-existing housing industry forecast.

That change is coming is obvious. The form that change will take remains unclear. Here are some possibilities: a) significant monies return to America due to a global profits repatriation holiday; b) the corporate tax rate will be reduced and the tax code simplified; c) an infrastructure-led stimulus package is fashioned and quickly implemented; d) all of the above.

The fact that the nonresidential construction industry's forecast is changing or at least must be reconsidered is good news. Previously, the industry's outlook was not altogether promising. Public construction spending has been slipping for months. Private construction spending has

been threatened by a combination of tightening credit conditions, projected increases in interest rates, potential shocks to asset prices, and growing evidence of mini-bubbles forming in certain geographies and product segments.

Many of the risks to the industry are traceable to a weak global economy. According to many forecasters, including those from the International Monetary Fund (IMF), the beginning of 2016 was supposed to bring a resurgence to the global economy, with the U.S. economy approaching 3.0 percent growth and many emerging markets righting themselves. The economists who generated these predictions were the same ones who predicted the Federal Reserve would raise short-term interest rates three or four times in 2016 as a response to the improving economic conditions in the country.

They were wrong. In recent months, the IMF has downgraded its global growth forecasts on multiple occasions, most recently in October 2016. According to the IMF, the inability of policymakers to address deep-rooted problems in the world's most important economies has thrown the world into its worst slow-growth rut in roughly 30 years.

As a result, the IMF's forecast for the global economy in 2016 is 3.1 percent, well below historical norms. Looking at developed countries like the U.S. and Japan, forecast growth is just 1.6 percent compared to 2.1 percent from a year ago. Additionally, the IMF recently slashed its outlook for 2016 U.S. economic growth from 2.2 percent in its July report to just 1.6 percent in its October submission.

Oddly enough, certain U.S. construction segments have been aided by a weak global economy. Given a lack of investment opportunities worldwide, a significant amount of foreign capital has flowed into the U.S. in search of a better combination of yield and safety. Some of this money has flowed into office, lodging, and commercial sectors, helping to explain the strength of these segments. Office-related construction spending expanded a whopping 23 percent over a recent 12-month period. Lodging-related construction, which incorporates hotel rooms, rose 20 percent during the same period.

Well, I'm sure Marcum's intrepid construction economist wishes he had it as easy as his local weatherman right now, with every day presenting a new chance to be right. But, as you'll read in his analysis, that is not the case. I'm teasing Anirban because very few of us could've predicted the major events of late. But, with the best knowledge at hand and, without question, the best mind around (his) hard-at-work on it, we will endeavor to adjust our forecasts and explain to you (and me) what recent changes in our country's leadership and business climate will mean for the construction industry.

Before anyone panics, let me say this: This could turn out to be good; very good for construction contractors. Infrastructure, deregulation, tax breaks and a shifting international climate could very well mean more investment in and into the States, more government projects and, in general, more opportunity for businesses to build and grow. I'll leave the details to the experts, but marvel with me for a moment at the office-related spending data: 23 percent growth over the last 12 months!

It's not going to be a straight-ahead bonanza, though. Upward wage pressure and access to talent have been challenges recently and could likely get even worse for contractors as demand grows over filling backlogs and new infrastructure bids come online. The same government stimulus that increases your volume may also increase your burden. But, then again, I'm no weatherman. So, I'll stick to being a trusted advisor to my clients in the construction industry and, I hope in some small way, even to a few of you as well.

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



Joseph Natarelli (right), Marcum's National Construction Industry Leader, introduced Brendan Bechtel, CEO of ENR #1-ranked contractor Bechtel Group Inc., at the Global Construction Summit in New York City on October 11. The Summit brought together the construction industry's leading world market experts and covered new and changing opportunities in Asia-Pacific, North and South America, Europe, and the Middle East.

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

Subsector	September 2016	1-month % Change	12-month % Change
Nonresidential	\$690,499	-0.9%	-0.7%
Office	\$70,706	-0.70%	23.00%
Lodging	\$28,811	0.30%	19.90%
Commercial	\$71,771	-2.90%	5.90%
Amusement & recreation	\$21,385	-2.30%	3.50%
Educational	\$87,074	0.30%	3.30%
Power	\$95,100	-1.10%	-1.90%
Highway & street	\$86,816	0.90%	-4.40%
Conservation & development	\$7,545	1.50%	-5.80%
Health care	\$41,009	-0.30%	-6.60%
Manufacturing	\$77,355	-1.50%	-6.70%
Religious	\$3,725	-5.10%	-7.90%
Transportation	\$41,653	-0.50%	-11.30%
Communication	\$18,618	-1.90%	-12.60%
Public safety	\$7,730	-0.90%	-13.00%
Water supply	\$11,492	0.40%	-13.70%
Sewage & waste disposal	\$19,711	-5.40%	-18.80%

Source: United States Census Bureau

Meanwhile, public spending has been incredibly weak. Construction spending declines have been recorded in sewage/waste disposal, water supply, public safety, transportation, conservation/development and highway/street.

Enter the new president. Both major presidential candidates had mentioned infrastructure spending as a part of their platforms. However, the prevailing notion had been that the new president would be intensely restrained by members of the other party. With the Republicans winning the presidency and holding onto the House and Senate, there is a much greater chance that a major infrastructure-led stimulus package is on the way. That could help lift nonresidential construction's fortunes over the next few years. If that money is spent wisely, it may help restructure the U.S. economy, enhancing efficiencies and elevating worker productivity.

Despite the lack of sufficient levels of infrastructure spending in recent years, the U.S. economy has been strong enough to tighten up the labor market. As of this writing, the official national unemployment rate stands at 4.9 percent. While many economic stakeholders express significant skepticism regarding the interpretation of unemployment rate measures, the fact of the matter is that most construction firms report intense difficulty securing electricians, heating/cooling professionals, welders, and carpenters, among others. The construction worker unemployment rate stood at 5.7 percent as of October 2016. That's a far cry from the 13.7 percent unemployment rate that prevailed precisely five years earlier.

Data from the Bureau of Labor Statistics' (BLS) Job Openings and Labor Turnover Survey indicate that construction job openings stand at a 10-year high. The Christian Science Monitor indicated in a recent article that demand for construction workers is so strong in Portland, Maine, that the Southern Maine Community College has had to suspend its construction technology program because too many students were leaving the program to accept employment offers.

▼ **Exhibit 2.** Construction Employment Growth in 20 Largest U.S. Metropolitan Areas  
September 2015 v. September 2016, Not Seasonally Adjusted

Rank	MSA	% Change	Rank	MSA	% Change
1	Phoenix-Mesa-Glendale, AZ	9.6%	11	Detroit-Warren-Livonia, MI*	3.8%
2	Boston-Cambridge-Quincy, MA-NH	9.0%	12	Minneapolis-St. Paul-Bloomington, MN-WI*	3.6%
3	Seattle-Tacoma-Bellevue, WA	7.9%	13	Los Angeles-Long Beach-Santa Ana, CA	3.0%
4	San Francisco-Oakland-Fremont, CA	7.7%	13	Washington-Arlington-Alexandria, DC-VA-MD-WV*	3.0%
5	Atlanta-Marietta, GA	6.6%	15	Philadelphia-Camden-Wilmington, PA-NJ-DE-MD*	2.7%
6	Miami-Fort Lauderdale-Pompano Beach, FL	6.2%	16	Dallas-Fort Worth-Arlington, TX*	2.5%
7	Tampa-St. Petersburg-Clearwater, FL	4.6%	17	Riverside-San Bernardino-Ontario, CA	2.4%
7	St. Louis, MO-IL	4.6%	18	Houston-Sugar Land, TX	-0.9%
9	Chicago-Joliet-Naperville, IL-IN-WI	4.2%	19	San Diego-Carlsbad-San Marcos, CA	-1.0%
9	New York-Northern New Jersey-L. Island, NY-NJ-PA*	4.2%	20	Baltimore-Towson, MD*	-1.7%

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

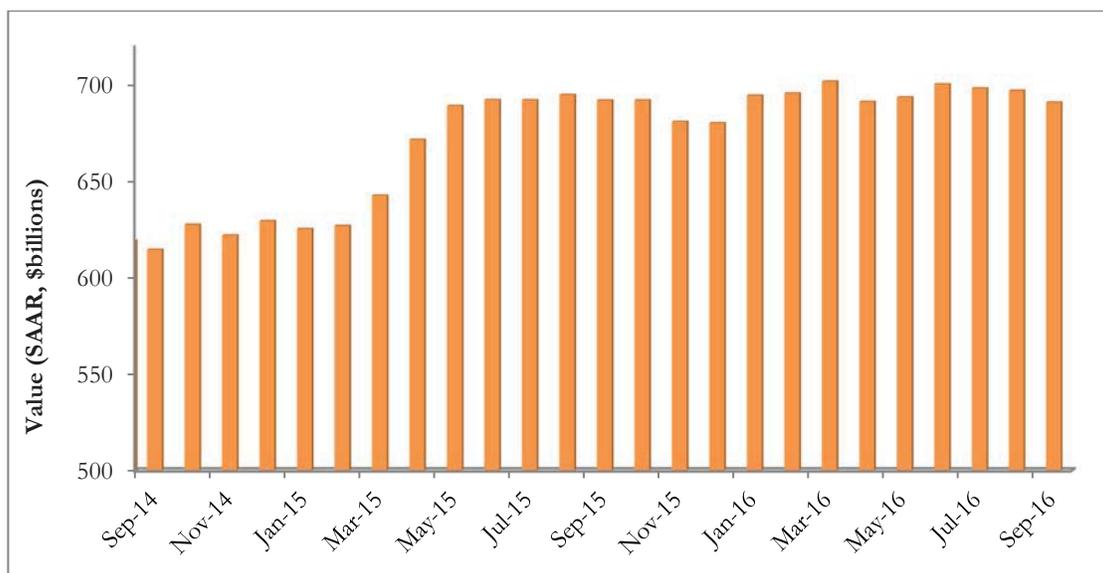
**Looking Ahead**

If a stimulus package is passed, many contractors will find that their respective backlogs are once again racing higher. It is interesting that a stimulus package is being considered when the nation is already so close to full employment. A stimulus package would accelerate wage increases. Wages are already rising faster than they have during any period over the past seven years. This creates longer-term risks to the industry.

As wages and other inflationary pressures build, interest rates are likely to head higher. While this process may or not begin in earnest in 2017, at some point, interest rates will be meaningfully higher than they are now.

That would be associated with many implications, including potentially impacting the U.S. stock market, reducing the value of bonds, diminishing commercial real estate values and those of apartment buildings. That, in turn, could hurt construction spending. The result would be that after a period of relatively intense construction spending due in part to a stimulus package, the nonresidential sector could face a sharp slowdown in construction spending thereafter.

▼ **Exhibit 3.** Nonresidential Construction Spending, September 2014 through September 2016



Sources: U.S. Census Bureau

Third Quarter 2016 Performance		Quarterly Values			% Change from	
Gross Domestic Product		2016Q3	2016Q2	2016Q1		
Overall Real GDP		2.9%	1.4%	0.8%	NA	NA
Nonresidential Fixed Investment in Structures		1.2%	1.0%	-3.4%	NA	NA
Construction Spending, Seasonally Adjusted (in \$millions)		Sep-16	Aug-16	Sep-15	Aug-16	Sep-15
Total Construction		\$1,150,005	\$1,154,388	\$1,152,122	-0.4%	-0.2%
Residential		\$459,506	\$457,806	\$456,559	0.4%	0.6%
Nonresidential		\$690,499	\$696,582	\$695,563	-0.9%	-0.7%
Lodging		\$28,811	\$28,712	\$24,029	0.3%	19.9%
Office		\$70,706	\$71,201	\$57,504	-0.7%	23.0%
Commercial		\$71,771	\$73,902	\$67,778	-2.9%	5.9%
Health care		\$41,009	\$41,126	\$43,899	-0.3%	-6.6%
Educational		\$87,074	\$86,771	\$84,256	0.3%	3.3%
Religious		\$3,725	\$3,925	\$4,045	-5.1%	-7.9%
Public safety		\$7,730	\$7,797	\$8,889	-0.9%	-13.0%
Amusement and recreation		\$21,385	\$21,880	\$20,660	-2.3%	3.5%
Transportation		\$41,653	\$41,842	\$46,962	-0.5%	-11.3%
Communication		\$18,618	\$18,981	\$21,309	-1.9%	-12.6%
Power		\$95,100	\$96,177	\$96,934	-1.1%	-1.9%
Highway and street		\$86,816	\$86,028	\$90,800	0.9%	-4.4%
Sewage and waste disposal		\$19,711	\$20,827	\$24,280	-5.4%	-18.8%
Water supply		\$11,492	\$11,447	\$13,310	0.4%	-13.7%
Conservation and development		\$7,545	\$7,436	\$8,008	1.5%	-5.8%
Manufacturing		\$77,355	\$78,531	\$82,901	-1.5%	-6.7%
Employment, Seasonally Adjusted (in thousands)		Oct-16	Sep-16	Oct-15	Sep-16	Oct-15
National Total Nonfarm		144,952	144,791	142,595	0.1%	1.7%
Construction		6,679	6,668	6,484	0.2%	3.0%
Residential building		737	735	691	0.4%	6.7%
Nonresidential building		727	728	722	-0.1%	0.8%
Heavy and civil engineering construction		936	933	937	0.4%	-0.1%
Residential specialty trade contractors		1,881	1,879	1,787	0.1%	5.2%
Nonresidential specialty trade contractors		2,398	2,394	2,347	0.2%	2.2%
Producer Prices		Sep-16	Aug-16	Sep-15	Aug-16	Sep-15
Finished Goods (seasonally adjusted)		108.1	107.4	108.5	0.7%	-0.4%
Inputs to Construction Industries		210.1	209.4	209.8	0.3%	0.1%
Softwood lumber (seasonally adjusted)		203.4	206.2	184.2	-1.4%	10.4%
Concrete products (seasonally adjusted)		248.5	248.2	240.7	0.1%	3.2%
Unprocessed energy materials (seasonally adjusted)		137.6	128.1	135.3	7.4%	1.7%
Iron and steel (not seasonally adjusted)		191.1	193.5	190.5	-1.2%	0.3%

## 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., as well as Grand Cayman, China and Ireland. 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 funds 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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- ▶ Corporate Revitalization
- ▶ Economic Damages
- ▶ Forensic Services
- ▶ Financial Advisory
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- ▶ Intellectual Property Disputes
- ▶ Litigation Support
- ▶ Loan Portfolio & Credit Risk
- ▶ Marital Dissolution
- ▶ Mergers & Acquisitions
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- ▶ Workplace Security & Investigations



### ▼ 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 has also chaired the annual 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. Anirban leads Marcum's research and analysis of the economic health of the commercial construction industry in America. Additionally, he writes the quarterly Marcum Commercial Construction Index and annual Marcum JOLT Survey analysis.

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