MARCUM Commercial Construction Index

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Economy Surging, Construction Industry with It.

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Construction Activity Elevated, More Skilled Labor Needed

Private nonresidential construction spending, which exceeded $460 billion in March on a seasonally adjusted, annualized basis, is at its highest observed level since the Census Bureau began tracking the series in 2002. While several subsectors have contributed to this record high, manufacturing-related construction spending is up 10.3 percent on a year-over-year basis and recently eclipsed $70 billion on an annualized basis for the first time in over two years.

According to the Institute for Supply Management's Manufacturing Purchasing Managers' Index (PMI), a leading indicator for the nation's industrial sector, domestic manufacturing activity has expanded during each of the past 32 months. While April's PMI of 52.8 percent was the lowest since October 2016, any reading above 50 percent indicates ongoing industrial expansion. As long as domestic manufacturing activity continues to expand, nonresidential construction activity should remain at or near record highs.

Exhibit 1. *Private Nonresidential Construction Spending, March 2019, Millions of Dollars, Seasonally Adjusted Annual Rate*

Subsector	March 2019	February 2019	March 2018	1-month % Change	12-month % Change
Nonresidential	$460,609	$458,508	$451,346	0.5%	2.1%
Lodging	$32,731	$32,160	$30,318	1.8%	8.0%
Office	$66,957	$66,415	$62,258	0.8%	7.5%
Commercial	$81,579	$83,737	$89,266	-2.6%	-8.6%
Health care	$33,803	$33,646	$33,007	0.5%	2.4%
Educational	$20,109	$20,323	$20,490	-1.1%	-1.9%
Religious	$2,973	$3,109	$3,093	-4.4%	-3.9%
Amusement and recreation	$14,622	$14,521	$14,123	0.7%	3.5%
Transportation	$17,788	$17,521	$16,216	1.5%	9.7%
Communication	$23,208	$23,044	$27,349	0.7%	-15.1%
Power	$95,059	$93,802	$91,184	1.3%	4.2%
Manufacturing	$70,184	$68,489	$63,262	2.5%	10.9%

Source: U.S. Census Bureau

Joe's View

It's (always) all about the people.

Record-level non-residential construction spending! Chart-topping industrial and manufacturing numbers! Increases in governmental resources and rumors of infrastructure plans! Office, lodging, public safety, recreation, transportation construction all growing at more than a 20% rate! What's left to do but go classic car shopping? Well, plenty, actually.

I don't mean to rain on the parade (and it is a great parade), but none of these data can mean profits or success if there are not folks around enough to do the jobs.

Focusing on your people is a three-part project: You have to get them. You have to pay them. You have to keep them. Based on what we've been seeing in our indices for quite a while, a future labor shortage is a real possibility which always means higher wages. The good news is that the salary increases we're seeing in the industry aren't all that high right now (about 3%). However, take a look around your company and the jobsite and consider the ages of your employees. You may find, as we did, that there is a meaningful portion of those workers who will be considering retirement in the next decade, or so. So, then what?

To secure the future, we need to ask questions, today: Is there the bench depth to replace retiring workers? Are there the education and skill development programs up and running to nurture that next generation of tradespeople? It's on us to know the answers to secure our futures and, whenever possible, to work with our communities and trade organizations to see that the answers to both questions are "Yes!"

I wish you a wonderful summer,

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

Exhibit 2. *Total Nonresidential Construction Spending, March 2019, Millions of Dollars, Seasonally Adjusted Annual Rate*

Subsector	March 2019	1-month % Change	12-month % Change	36-month % Change
Nonresidential	$775,231	-0.3%	4.8%	9.4%
Lodging	$33,685	1.5%	7.7%	27.2%
Office	$77,426	1.0%	8.6%	23.1%
Commercial	$86,074	-2.5%	-7.1%	14.6%
Health care	$42,128	-0.2%	0.7%	2.9%
Educational	$96,736	-1.4%	4.1%	6.8%
Religious	$2,973	-4.4%	-3.9%	-18.9%
Public safety	$9,539	-1.4%	7.2%	23.5%
Amusement and recreation	$27,065	-2.3%	7.8%	23.5%
Transportation	$52,737	0.7%	6.7%	22.5%
Communication	$23,414	1.0%	-15.0%	13.6%
Power	$100,986	1.2%	3.9%	5.5%
Highway and street	$104,921	-2.0%	13.4%	9.6%
Sewage and waste disposal	$24,221	1.2%	9.2%	-3.8%
Water supply	$14,438	-1.8%	13.8%	9.4%
Conservation and development	$8,550	-0.7%	13.5%	13.4%
Manufacturing	$70,339	2.5%	10.3%	-10.4%

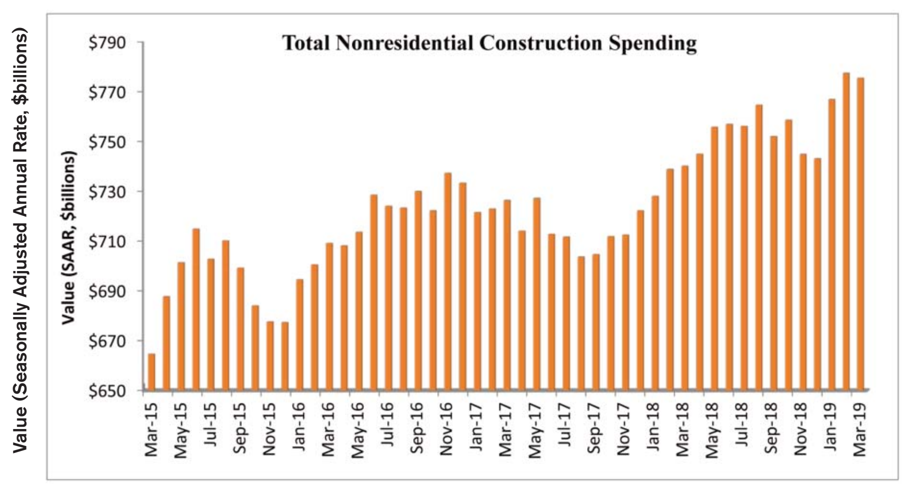
Source: U.S. Census Bureau

Another tailwind to the construction industry takes the form of improved state and local government finances. Ten years of economic expansion and a stock market that has generally created new wealth has bulked up income, property, sales, and other tax collections. That supplies more money for infrastructure, including in categories such as education, public safety and transportation.

As a result, public construction spending increased 9 percent from March 2018 to March 2019. Spending in the highway and street category expanded 13.4 percent over that period and as of February 2019 surpassed power as the largest nonresidential construction subsector.

With lengthy backlogs in hand and given the ongoing momentum apparent in the U.S. economy, contractors have little reason for concern regarding near-term demand for construction services. Accordingly, hiring activity continues to be robust even in the context of large-scale construction skills shortfalls.

Exhibit 3. *Nonresidential Construction Spending, March 2015 through March 2019*



Source: U.S. Census Bureau

In April, construction industry employment expanded by 33,000 net new positions, with nonresidential construction adding 32,400 of those jobs. Over the past 12 months, the overall construction industry has added 256,000 jobs on net, representing a heady increase of 3.5 percent. Nonresidential construction has represented much of the construction sector's job growth over the past year, with residential homebuilders struggling amidst a general dearth of interest among first-time and move-up buyers alike in the wake of higher home prices. Between nonresidential building, heavy & civil engineering, and nonresidential specialty trade contractors, nonresidential construction added nearly 163,000 jobs on net for the one-year period ended April 2019.

Not surprisingly, the construction industry unemployment rate has continued to fall as available workers are scooped up by engaged contractors. Over the past year, the industry's unemployment rate fell another 2.2 percentage points, dropping the industry's unemployment rate meaningfully below 5 percent. April's 4.7 percent industry unemployment rate represented the lowest construction unemployment recorded for any April since the Bureau of Labor Statistics began reporting this statistic in 2000.

With workers increasingly scarce, more communities, business groups, and individual employers are supporting apprenticeship programs. But putting these programs in place and acquiring the required government approvals takes time. The implication is that contractors will continue to find it difficult to secure a ready and reliable workforce.

Given both quantified and anecdotal information regarding the growing scarcity of workers, one might suspect that construction wages would be surging. But they are not. Average hourly earnings for construction employees increased 3.1 percent over the past calendar year, a tenth of a percentage point slower than the average for all industries.

How could this be? The answer likely rests with a composition shift in the construction workforce. Many of the industry's most productive, reliable and highly compensated workers are in their 50s and 60s. Increasingly, they are moving into retirement or perhaps transitioning into less physically demanding occupations. The result is that their lofty compensation is being removed from the wage statistic even as less skilled workers enter the industry, thereby suppressing the apparent pace of construction wage increases.

Exhibit 4. *Construction Employment Growth, 20 Largest U.S. Metropolitan Areas, April 2018 v. April 2019, Not Seasonally Adjusted*

Rank	MSA	% Change	Rank	MSA	% Change
1	Phoenix-Mesa-Scottsdale, AZ	11.4%	10	St. Louis, MO-IL*	3.1%
2	Seattle-Tacoma-Bellevue, WA	6.3%	12	Boston-Cambridge-Nashua, MA-NH*	2.5%
2	San Francisco-Oakland-Hayward, CA	6.3%	13	Minneapolis-St. Paul-Bloomington, MN-WI*	2.1%
4	Atlanta-Sandy Springs-Roswell, GA	6.2%	14	Baltimore-Columbia-Towson, MD*	1.8%
5	Tampa-St. Petersburg-Clearwater, FL	5.2%	15	Los Angeles-Long Beach-Anaheim, CA	1.3%
6	Philadelphia-Camden-Wilmington, PA-NJ-DE-MD*	5.0%	16	Riverside-San Bernardino-Ontario, CA	1.0%
7	Miami-Fort Lauderdale-West Palm Beach, FL	4.1%	16	Houston-The Woodlands-Sugar Land, TX	1.0%
8	New York-Newark-Jersey City, NY-NJ-PA*	4.0%	18	Chicago-Naperville-Elgin, IL-IN-WI	-0.4%
9	Detroit-Warren-Dearborn, MI*	3.9%	19	Washington-Arlington-Alexandria, DC-VA-MD-WV*	-0.5%
10	Dallas-Fort Worth-Arlington, TX*	3.1%	20	San Diego-Carlsbad, CA	-1.3%

Source: U.S. Bureau of Labor Statistics

The Economy is Good, but Maybe for the Wrong Reasons

It was the best of economic times; it was a somewhat disappointing time – it all depends on which data one chooses to believe and how one interacts with the economy. The issue is not the data, of course, but the interpretations.

There are plenty of data to support all sides of the debate regarding how well the economy is performing. Low unemployment, surging stock prices, rising outlays on infrastructure and steady wage gains point to a strong economy. On the other hand, slower-than-expected wage growth (as least until recently), surging trade and federal budget deficits, and a number of weak data readings, including those relating to retail sales and small business confidence, suggest something different is at hand.

Advantage: glass half full. The nation is currently on an unprecedented winning streak. The global financial crisis of 2008-09 resulted in the total number of U.S. jobs dropping to a mere 129.7 million in early 2010 from a previous peak of 138.4 million achieved during the very late stages of 2007. The loss of 8.7 million jobs pushed U.S. employment back down to levels not observed since September 1999. But that was about ten and twenty years ago. Today, the labor market is humming.

Since that low point, the economy has created 21.4 million net new jobs, an increase of 16.4 percent. Rising wages and longer hours have induced many to give up their second job, freeing up employment opportunities for others. According to the latest employment estimates from the BLS, the nation added 263,000 net new positions in April 2019, blowing past expectations. Over the past 12 months for which data are available, America has added more than 2.5 million net new jobs.

Solid employment growth in both March and April 2019 proved that weak data observed earlier in the quarter were simply an aberration. According to the BLS' initial release of February employment data, that month America added only 20,000 net new jobs. That has subsequently been revised considerable higher, but at the time it seemed to represent evidence that the U.S. economy was losing steam. Data from December indicated outrageously weak retail sales. A growing volume of data also indicated a weakening global economy, helping to ratchet down measures of U.S. industrial production and capacity utilization. Many economists suggested that this was evidence that the tax cuts passed in latge-2017 had stopped working.

But weak months have a tendency to sneak into the employment data series even during robust economic times. For instance, in September 2017, the nation registered a meager 18,000 net new jobs. Hurricanes touching down around the Gulf Coast had a significant impact on major centers of employment in Texas and Florida, helping to produce a weak employment report. Though there were no major natural disasters shaping the February data, there was some human-generated interference. In particular, a federal government shutdown that commenced in late-2018 helped to create difficulties in data collection and measurement. The Upper Midwest and New England also sustained very cold temperatures even by their own standards in February, constraining economic activity in places like Minnesota, Iowa and Nebraska.

The narrative has certainly changed recently and then changed again. With both Chinese and U.S. economic performance improving recently, the global economic outlook appeared less dire. Moreover, ongoing U.S. job growth and seemingly insatiable demand for workers will keep the virtuous cycle going for the next few quarters. The 2020 recession scenario remains a possibility, but has begun to unravel in the context of strong GDP growth, remarkable labor market performance, rising wages and incredibly low inflation in the midst of a 10th year of economic expansion.

Potential Threats Remain

Despite the seemingly rosy economic outlook, a few potential threats could disrupt the ongoing momentum. The most immediate one is ongoing trade tensions between the U.S. and China, which have suppressed economic confidence. On May 10, the U.S. raised tariffs from 10 percent to 25 percent on $200 billion of Chinese goods. The Chinese government has promised to retaliate. Markets have been shaken, with early-May associated with the worst week for U.S. equity investors in 2019.

Corporate debt represents another potential threat to ongoing economic momentum. In 2007, corporate debt totaled just $4.7 trillion. Corporate debt now totals $9.6 trillion, essentially doubling in a bit more than a decade. Much of this debt is either junk or just a bit better than junk. Any widespread downgrades of corporate debt could conceivably yield a corporate credit crunch, perhaps enough of one to motivate the next downturn.

That said, one could make the case that such fears are wildly overblown. Not only is the economy growing presently, which supports cash flow, but the tax reform passed in late-2017 has freed up significant capital for companies to claw away at their accumulated debt. According to an analysis by Moody's Investor Services, the top 100 nonfinancial corporations spent more than $70 billion of new cash flows on debt repayment.

Looking Ahead

For the last two years, we have been predicting that the next downturn would begin in late-2020 or in 2021. It still might, but our prior recession thesis has admittedly unraveled.

The expectation was that as U.S. unemployment drifted lower, problematic inflationary pressures would emerge, triggering ongoing increases in short- and long-term interest rates. Indeed, the Federal Reserve had been deeply concerned by the notion that inflationary pressures would become more apparent as the economic expansion persisted. In response, Federal Reserve policymakers raised key short-term rates 9 times since December 2015.

As predicted, unemployment has continued to fall, now down to 3.6 percent nationally, effectively a five-decade low. But something strange happened on the way to a 50-year low in unemployment – inflation dissipated. There are many reasons for this, including the Amazon effect—the ongoing disruption of brick and mortar retail—low healthcare inflation, falling apparel prices, and a slowing global economy.

While problematic inflation may ultimately rear its ugly head, for now inflationary pressures remain benign. Interest rates have remained well behaved in response and have actually been dipping in recent months. Many investors believe that the Federal Reserve's next move will be to cut rates as opposed to raising them, which could conceivably lead to even lower borrowing costs for businesses and consumers. None of this appears to serve as prologue to a recession.

On the other hand, the probability of a full-blown trade war between the world's two largest economies has expanded recently. Brexit continues to hang over financial markets and the global economy. Corporate debt is a problem as America's national debt recently surged past the $22 trillion mark. Another federal debt crisis ceiling is possible later this year. In nominal terms, consumer debt has never been higher, though monthly debt service payments remain manageable in the context of unusually low interest rates.

Then there is next year's presidential election. Elections help stimulate a psychology of uncertainty, which results in less spending and investment. If the global economy continues to slow, markets give back some of their gains, and inflation finally becomes apparent, 2020 could be the year of the next downturn. It remains too soon to give up on that recession prognostication.

First Quarter 2019 Performance	Values			% Change from	
Gross Domestic Product (% Growth, SAAR)	**2019Q1[1]**	**2018Q4**	**2018Q3**		
Overall Real GDP	3.2%	2.2%	3.4%	NA	NA
Nonresidential Fixed Investment in Structures	-0.8%	-3.9%	-3.4%	NA	NA
Construction Spending, SA ($Millions)	**Mar-19**	**Feb-19**	**Mar-18**	**Feb-19**	**Mar-18**
Total Construction	*$1,282,205*	*$1,293,330*	*$1,293,125*	*-0.9%*	*-0.8%*
Residential	*$506,975*	*$516,121*	*$553,217*	*-1.8%*	*-8.4%*
Nonresidential	*$775,231*	*$777,209*	*$739,907*	*-0.3%*	*4.8%*
Lodging	$33,685	$33,181	$31,274	1.5%	7.7%
Office	$77,426	$76,665	$71,272	1.0%	8.6%
Commercial	$86,074	$88,263	$92,667	-2.5%	-7.1%
Health care	$42,128	$42,206	$41,823	-0.2%	0.7%
Educational	$96,736	$98,116	$92,908	-1.4%	4.1%
Religious	$2,973	$3,109	$3,093	-4.4%	-3.9%
Public safety	$9,539	$9,679	$8,900	-1.4%	7.2%
Amusement and recreation	$27,065	$27,692	$25,099	-2.3%	7.8%
Transportation	$52,737	$52,381	$49,446	0.7%	6.7%
Communication	$23,414	$23,183	$27,553	1.0%	-15.0%
Power	$100,986	$99,796	$97,187	1.2%	3.9%
Highway and street	$104,921	$107,045	$92,551	-2.0%	13.4%
Sewage and waste disposal	$24,221	$23,938	$22,173	1.2%	9.2%
Water supply	$14,438	$14,707	$12,691	-1.8%	13.8%
Conservation and development	$8,550	$8,606	$7,531	-0.7%	13.5%
Manufacturing	$70,339	$68,644	$63,743	2.5%	10.3%
Employment, SA (in thousands)	**Apr-19**	**Mar-19**	**Apr-18**	**Mar-19**	**Apr-18**
National Total Nonfarm	151,095.0	150,832.0	148,475.0	0.2%	1.8%
Construction	7,486.0	7,453.0	7,230.0	0.4%	3.5%
Residential building	834.1	836.6	795.1	-0.3%	4.9%
Nonresidential building	820.2	819.8	821.2	0.0%	-0.1%
Heavy and civil engineering construction	1,087.8	1,077.9	1,038.3	0.9%	4.8%
Residential specialty trade contractors	2,065.1	2,062.0	2,011.3	0.2%	2.7%
Nonresidential specialty trade contractors	2,678.3	2,656.2	2,564.0	0.8%	4.5%
Producer Price Index, NSA [2]	**Mar-19**	**Feb-19**	**Mar-18**	**Feb-19**	**Mar-18**
Finished Goods (SA)	115.8	114.6	114.3	1.0%	1.3%
Inputs to Construction Industries	232.3	228.5	226.6	1.7%	2.5%
General Contractors (New Nonresidential Building Const.)	112.9	112.8	107.8	0.1%	4.7%
New Nonresidential Building Construction (U.S.)	113.8	113.7	108.4	0.1%	5.0%
Northeast	114.0	113.8	108.8	0.2%	4.8%
South	113.7	113.6	108.1	0.1%	5.2%
Midwest	110.8	110.7	106.4	0.1%	4.1%
West	116.5	116.3	110.1	0.2%	5.8%

Source: U.S. Bureau of Economic Analysis; U.S. Census Bureau; U.S. Bureau of Labor Statistics.

[1] *Advance (1st) Estimate.*

[2] *SA: Seasonally Adjusted. NSA: Not Seasonally Adjusted.*

[3] *The* ***Producer Price Index (PPI)*** *program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services. All figures are indexed from a base year, that base year being different for each individual index.*

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Joseph Natarelli

Joseph Natarelli is national leader of Marcum's Construction Industry Practice and office managing partner in New Haven. 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.

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