# MARCUM Commercial Construction Index

## IN THIS ISSUE



Issue 22 | Fourth Quarter 2017


# 2018 Is Shaping Up to be Excellent

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### Momentum Builds after Solid 2017

Within a few months, the current, much-critiqued, intensely scrutinized economic expansion will begin its 10th year. Given the level of present momentum in early 2018, there is every reason to believe that the current expansion cycle will become the longest in U.S. economic history.

Though many have complained about slow wage and soft GDP growth, future commentators are likely to consider the past few years as very good ones for the U.S.; years associated with steadily declining unemployment, low inflation, responsive monetary policymaking, and surging asset prices. After years of surprisingly strong profit growth, corporate America is generally healthy. Banks are lending again. The recently passed federal tax cut will translate into even more liquidity and greater incentive to pursue profitability.

Accordingly, the outlook for 2018 is perhaps the most positive since around 2005, when the housing market boom remained in full bloom. There will be many beneficiaries from this economic strength, including owners of real estate, retailers, construction firms, logistics suppliers, and other highly cyclical enterprises.

Even prior to the federal tax cut that brings the official U.S. corporate tax rate from 35 percent to 21 percent, doubles the standard deduction while reducing marginal tax rates, and introduces a new 20 percent deduction for pass-through business income, the U.S. economy was humming. The U.S. economy expanded at better than a 3 percent annualized rate during both the second and third quarters, and finished the year with 2.6 percent growth in the final quarter of 2017. The reason that the fourth quarter came in sub-3 percent had much to do with plentiful spending by consumers on imports, which translated into a larger trade deficit. In other words, the sub-3 percent reading for 2017's final quarter was not due to economic weakness, but ironically, to economic strength and an active consumer.

This momentum has naturally triggered more activity in many construction segments. Nonresidential construction spending expanded 0.8 percent in December, totaling $720.4 billion on a seasonally adjusted basis according to data released by the U.S. Census Bureau. This represented the fifth consecutive month during which nonresidential spending has increased.

Unlike prior years, much of the growth in nonresidential construction spending has been driven by public construction outlays. Public nonresidential construction expanded 0.4 percent on a monthly basis in December and was up 4.4 percent on a year-ago basis. By contrast, certain private construction segments have not experienced spending growth recently. Spending in the power and manufacturing categories, two of the largest nonresidential subsectors, have contracted by a combined 10.3 percent, or $18.2 billion, since December 2016.

## Joe's View

Happy New Year to all our readers. And what a year we just wrapped up. 2017 proved to be another solid year of growth and economic success for the USA. Now, as we have rounded the corner on 2018, what lays ahead? We cannot ignore the 10-year recessionary cycle event horizon we're hurtling towards, but there appears to still be hope for continued growth. The momentum of last year has carried us into another prosperous quarter and the signs we look to, for the near-term, seem to say "more to come."

In our corner of the business world, nonresidential construction is still on the rise. For example, public construction jobs are up around 4%, year-over-year. We can look to the public sector for even more growth in 2018 and beyond, as the current administration develops and, hopefully, executes their infrastructure plan.

On a personal note, as a resident of Connecticut and frequent traveler to New York, I have the pleasure of driving on and under the ornate bridges and down the picturesque Merritt Parkway built by the Public Works Administration the 1930's, and I think of the contractors, artisans, and laborers it must've employed. Maybe our kids and grandkids will have a similar tale to tell.

Have a great Spring and may the thaw bring you lots of work.

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*National Construction Industry Group Leader, Marcum LLP*

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**Exhibit 1.** *Nonresidential Spending, December 2017, Millions of dollars, Seasonally Adjusted Annual Rate*

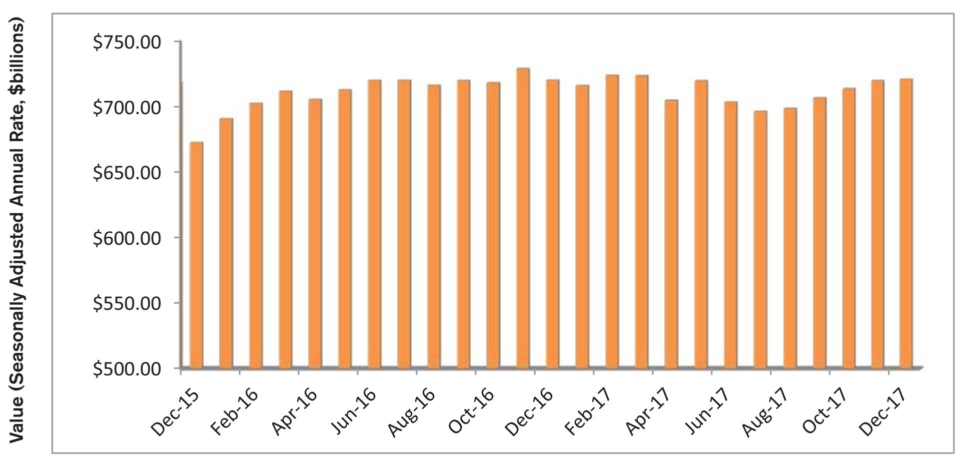
| Subsector | December 2017 | 1-month % Change | 12-month % Change | 36-month % Change |
|---|---|---|---|---|
| **Nonresidential** | **$720,371** | **0.8%** | **0.1%** | **14.5%** |
| Lodging | $29,869 | 3.2% | 4.8% | 67.0% |
| Office | $71,228 | 3.4% | -2.8% | 47.9% |
| Commercial | $88,987 | 1.8% | 5.1% | 41.3% |
| Health care | $41,353 | 0.4% | 6.3% | 6.1% |
| Educational | $97,237 | 2.1% | 6.6% | 24.6% |
| Religious | $3,112 | 2.3% | -8.3% | -12.4% |
| Public safety | $8,913 | 4.7% | 4.6% | -2.7% |
| Amusement and recreation | $23,363 | 0.0% | 1.1% | 25.3% |
| Transportation | $47,071 | -0.1% | 12.9% | 8.2% |
| Communication | $23,643 | 1.3% | 2.6% | 49.1% |
| Power | $97,169 | -1.3% | -9.4% | 1.0% |
| Highway and street | $88,459 | 0.3% | 1.5% | 4.5% |
| Sewage and waste disposal | $20,159 | -2.9% | 1.6% | -21.5% |
| Water supply | $10,893 | -0.8% | -10.6% | -19.9% |
| Conservation and development | $7,717 | 1.6% | 2.1% | -5.8% |
| Manufacturing | $61,199 | -0.3% | -11.7% | -4.7% |

*Source: U.S. Census Bureau*

While data releases are important for many reasons, including helping to understand what happened in the past, their principal value lies in clarifying our shared understanding of the probable future. To the extent that current data trends can be explained by pointing to various influencing factors, and to the extent that these factors continue to persist in effect, one can with some confidence predict that current trends will last for the foreseeable future. However, when there is some significant shift in the economic environment, current trends become far less useful in predicting future ones.

Such is the case today. The future is likely to represent a departure from prior trends, in large measure because of the recently enacted tax reform bill. The tax cut will further bolster private sector liquidity and confidence, which will ultimately translate into more construction starts and spending. If long-awaited progress is made on infrastructure spending, the construction recovery will likely transition from solid to spectacular.

**Exhibit 2.** *Nonresidential Construction Spending, December 2015 through December 2017*




*Source: U.S. Census Bureau*

The latest employment report from the Bureau of Labor Statistics indicates growth in both public and private construction activity. Construction added 36,000 net new jobs in January, an impressive increase of 0.5 percent on a month-over-month basis. During the past 12 months, construction has added 226,000 net new jobs, which translates into 3.3 percent growth. The nation added 200,000 jobs across all non-farm segments in January, which means that construction comprised an impressive 18 percent of all net new job creation in America.

Nonresidential construction added 16,400 net new positions in January, including substantial job growth in the heavy and civil engineering (6,300 jobs) and nonresidential specialty trade (12,400 net new positions) segments. Growth in staffing levels in heavy and civil engineering is indicative of rising public construction expenditures, while the growth in nonresidential specialty trade contractors appears to be more closely related to stronger private spending in certain segments. At 7.3 percent, the construction unemployment rate is 2.1 percentage points lower than it was a year ago, consistent with the notion of expanding human capital shortfalls. The national unemployment rate remained at 4.1 percent for a fourth consecutive month.

**Exhibit 3.** *Construction Employment Growth, 20 Largest U.S. Metropolitan Areas, December 2016 v. December 2017, Not Seasonally Adjusted*

| Rank | MSA | % Change | Rank | MSA | Percent Change |
|---|---|---|---|---|---|
| 1 | Riverside-San Bernardino-Ontario, CA | 15.1% | 11 | San Diego-Carlsbad-San Marcos, CA | 4.3% |
| 2 | Minneapolis-St. Paul-Bloomington, MN-WI* | 10.3% | 12 | Boston-Cambridge-Quincy, MA-NH | 3.7% |
| 3 | San Francisco-Oakland-Fremont, CA | 8.8% | 13 | St. Louis, MO-IL | 3.0% |
| 4 | Detroit-Warren-Livonia, MI* | 7.5% | 14 | New York-Northern New Jersey-L. Island, NY-NJ-PA* | 2.9% |
| 5 | Miami-Fort Lauderdale-Pompano Beach, FL | 7.4% | 15 | Baltimore-Towson, MD* | 2.6% |
| 6 | Phoenix-Mesa-Glendale, AZ | 7.3% | 16 | Washington-Arlington-Alexandria, DC-VA-MD-WV* | 2.4% |
| 7 | Seattle-Tacoma-Bellevue, WA | 6.6% | 17 | Philadelphia-Camden-Wilmington, PA-NJ-DE-MD* | 1.2% |
| 8 | Los Angeles-Long Beach-Santa Ana, CA | 6.0% | 18 | Tampa-St. Petersburg-Clearwater, FL | 0.9% |
| 9 | Chicago-Joliet-Naperville, IL-IN-WI | 5.1% | 19 | Dallas-Fort Worth-Arlington, TX* | 0.4% |
| 10 | Atlanta-Marietta, GA | 4.9% | 20 | Houston-Sugar Land, TX | -0.4% |

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

Any lingering concerns regarding the labor market after December's somewhat weak report should be completely dispelled by now. America's economy is now firing on many cylinders due to a combination of solid consumer spending growth, accelerating business outlays, and stronger exports. All of this ends up translating into demand for construction services, which remains on the rise and continues to trigger available job openings. In recent months, the number of unfilled, available construction job openings has been in the range of 200,000 positions on average according to the government's Job Openings and Labor Turnover Survey.

**Looking Ahead**

The rest of the year is shaping up to be a period of strong economic growth. While the U.S. economy may not reach 3 percent growth in 2018, it is likely to come quite close. Asset prices, however, may continue to behave erratically due to a combination of uncertain monetary policy, already elevated valuations, and the specter of more apparent inflation due to faster increases in employee compensation, healthcare costs, tuitions, rents, etc. Stakeholders should, accordingly, pay close attention to inflation data and Federal Reserve pronouncements.

Among the sources of faster growth in 2018 are consumer spending, the owner-occupied housing market, business spending, and exports. Government spending at the federal level is emerging as another contributor. Before a recent budget deal, most economists believed that Congress would strive to cut spending in order to pay for the recent tax cut and in an effort to eventually balance America's budget. Instead, Congress recently approved a budget that will raise federal outlays by nearly $400 billion over the next two fiscal years. That may eventually come back to haunt America, but represents a further source of economic support in the near-term.

The most obvious and likely threat to the current economic expansion cycle is a combination of surprisingly robust inflation, rising interest rates, and falling asset prices. During a recent week, the Dow Jones Industrial Average fell by more than 1,000 points on two occasions. This should remind stakeholders how volatile financial markets can be, particularly after a period of remarkable gains in share prices.

| Fourth Quarter 2017 Performance | Values | | | % Change from | |
|---|---|---|---|---|---|
| **Gross Domestic Product** | **2017Q4[1]** | **2017Q3** | **2017Q2** | | |
| Overall Real GDP | 2.6% | 3.2% | 3.1% | NA | NA |
| Nonresidential Fixed Investment in Structures | 6.8% | 4.7% | 6.7% | NA | NA |
| **Construction Spending, Seasonally Adjusted (in $millions)** | **Dec-17** | **Nov-17** | **Dec-16** | **Nov-17** | **Dec-16** |
| *Total Construction* | $1,253,294 | $1,245,057 | $1,221,584 | 0.7% | 2.6% |
| *Residential* | $532,923 | $530,646 | $501,955 | 0.4% | 6.2% |
| *Nonresidential* | $720,371 | $714,411 | $719,629 | 0.8% | 0.1% |
| Lodging | $29,869 | $28,954 | $28,497 | 3.2% | 4.8% |
| Office | $71,228 | $68,911 | $73,275 | 3.4% | -2.8% |
| Commercial | $88,987 | $87,410 | $84,704 | 1.8% | 5.1% |
| Health care | $41,353 | $41,208 | $38,914 | 0.4% | 6.3% |
| Educational | $97,237 | $95,216 | $91,195 | 2.1% | 6.6% |
| Religious | $3,112 | $3,043 | $3,395 | 2.3% | -8.3% |
| Public safety | $8,913 | $8,510 | $8,519 | 4.7% | 4.6% |
| Amusement and recreation | $23,363 | $23,362 | $23,099 | 0.0% | 1.1% |
| Transportation | $47,071 | $47,105 | $41,707 | -0.1% | 12.9% |
| Communication | $23,643 | $23,339 | $23,051 | 1.3% | 2.6% |
| Power | $97,169 | $98,473 | $107,252 | -1.3% | -9.4% |
| Highway and street | $88,459 | $88,192 | $87,124 | 0.3% | 1.5% |
| Sewage and waste disposal | $20,159 | $20,752 | $19,838 | -2.9% | 1.6% |
| Water supply | $10,893 | $10,978 | $12,191 | -0.8% | -10.6% |
| Conservation and development | $7,717 | $7,596 | $7,561 | 1.6% | 2.1% |
| Manufacturing | $61,199 | $61,362 | $69,308 | -0.3% | -11.7% |
| **Employment, Seasonally Adjusted (in thousands)** | **Jan-18** | **Dec-17** | **Jan-17** | **Jan-18** | **Dec-17** |
| *National Total Nonfarm* | 147,810 | 147,610 | 145,696 | 0.1% | 1.5% |
| *Construction* | 7,099 | 7,063 | 6,873 | 0.5% | 3.3% |
| Residential building | 772.0 | 766.9 | 747.3 | 0.7% | 3.3% |
| Nonresidential building | 794.2 | 796.5 | 775.3 | -0.3% | 2.4% |
| Heavy and civil engineering construction | 993.4 | 987.1 | 968.5 | 0.6% | 2.6% |
| Residential specialty trade contractors | 1,996.4 | 1,982.5 | 1,932.7 | 0.7% | 3.3% |
| Nonresidential specialty trade contractors | 2,542.5 | 2,530.1 | 2,449.1 | 0.5% | 3.8% |
| **Producer Price Index[2]** | **Jan-18** | **Dec-17** | **Jan-17** | **Jan-18** | **Dec-17** |
| *Finished Goods (seasonally adjusted)* | 113.9 | 113.1 | 110.2 | 0.7% | 3.4% |
| *Inputs to Construction Industries* | 222.8 | 220.4 | 212.4 | 1.1% | 4.9% |
| Nonresidential general contractors | 107.6 | 107 | 104.3 | 0.6% | 3.2% |
| New nonresidential building construction, National | 116.4 | 115.5 | 112.4 | 0.8% | 3.6% |
| New nonresidential building construction, Northeast | 108.8 | 108.1 | 104.4 | 0.6% | 4.2% |
| New nonresidential building construction, South | 108.0 | 107.3 | 105.3 | 0.7% | 2.6% |
| New nonresidential building construction, Midwest | 106.0 | 105.2 | 102.8 | 0.8% | 3.1% |
| New nonresidential building construction, West | 109.6 | 108.3 | 105.3 | 1.2% | 4.1% |

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

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

[2] *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 the national leader of Marcum's Construction Industry Practice and an 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.

## 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 and is a keynote presenter at the Firm's construction industry summits.

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