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MARCUM Commercial Construction Index

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It was a Fine Year for Nonresidential Construction

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America's Construction Economy

Ask many contractors about 2018, and they may say things like "we had more work than we knew what to do with" or "we had a record year." While this wasn't true for all contractors, many found 2018 to be a busy and profitable period. Various indicators ranging from Associated Builders and Contractors' Construction Backlog Indicator to the American Institute of Architects' Architecture Billings Index suggest that construction spending momentum will persist into 2019.

While there has been some stagnation in nonresidential construction spending growth in recent months, according to data released on March 4, nonresidential construction spending totaled $750.5 billion on a seasonally adjusted annualized basis in December 2018, up 4 percent from a year ago. Public spending was up 4.8 percent on a year-over-year basis while private construction spending was up 3.4 percent.

Exhibit 1. *Nonresidential Construction Spending, December 2018, Millions of Dollars, Seasonally Adjusted Annual Rate*

Subsector	December 2018	1-month % Change	12-month % Change	36-month % Change
Nonresidential	**$750,540**	**0.0%**	**4.0%**	**10.4%**
Lodging	$33,578	1.00%	11.00%	52.50%
Amusement and recreation	$27,088	-1.10%	7.80%	31.50%
Office	$74,835	0.80%	8.20%	28.60%
Commercial	$86,188	-0.70%	-3.20%	22.30%
Transportation	$53,088	-1.50%	6.20%	17.00%
Power	$98,838	-0.20%	7.70%	14.00%
Educational	$98,462	-0.60%	5.70%	12.90%
Public safety	$9,335	0.60%	5.10%	10.70%
Communication	$24,964	4.60%	-1.10%	10.30%
Conservation and development	$7,467	-1.20%	-1.50%	7.20%
Water supply	$13,041	-0.30%	8.50%	7.10%
Health care	$41,360	0.80%	-4.50%	6.50%
Religious	$3,028	-2.00%	1.70%	-2.00%
Highway and street	$89,482	-0.80%	1.80%	-4.80%
Sewage and waste disposal	$22,058	-0.40%	4.50%	-8.70%
Manufacturing	$67,727	1.70%	5.00%	-14.20%

Source: U.S. Census Bureau

What a year!

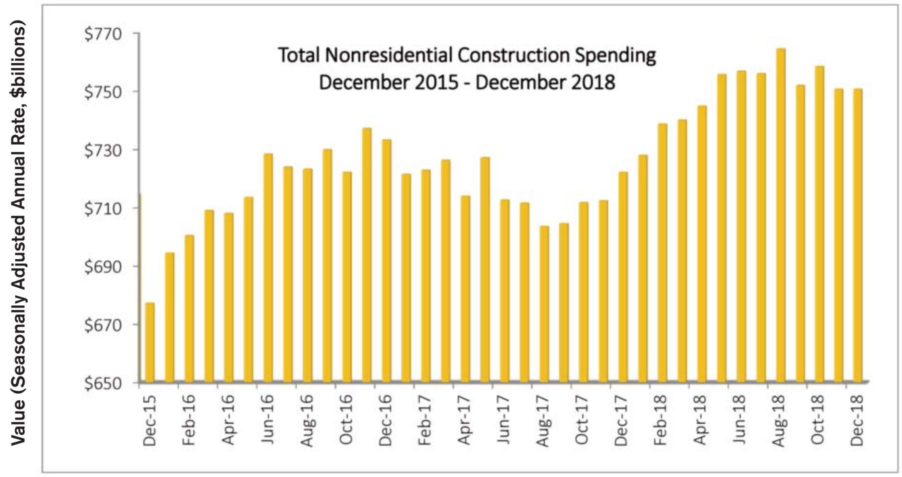
As you're reading this, I hope that you can count yourself among the contractors who found themselves almost too busy this past year. And, if not, I hope that you, at least, were able to capture even greater profits than before, during the past 12 months. So many things had to come together to create this advantageous environment for our industry. Of the many factors at play, as you'll read in this analysis of our quarterly index, not only do backlog indicators show that it was a great year, but they also point towards continued volume in the year to come. Just a highlight: don't miss our table on nonresidential spending…it's a doozy (more than 50% of categories showed double-digit growth over a 36-month period including a 52% increase in the lodging subcategory)!

As you know, Marcum counts jobs and employment data as key indicators on the health and status of the construction industry (please check out our Job Openings and Labor Turnover report on our website). I'm always happy to report positive trends, but I do tend to offer some cautions with them and a potential labor shortage has been my most frequent warning. In December alone, new construction jobs were nearly half of the total jobs created in the country. Based on the momentum of 2018, I think that labor and staffing will continue to be at the top or near the top of the challenges successful construction contractors will face in the coming months.

Just because I have the questions doesn't mean I have the answers, of course. So, I'll tell you something I hold true to my heart and leave it at that: Take care of your people and please support the trades.

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

Exhibit 2. *Nonresidential Construction Spending, December 2015 through December 2018*



Source: U.S. Census Bureau

These growth figures hardly sound spectacular, but must be further considered in the context of human capital supply constraints. While demand for construction services has been strong, the nonresidential construction industry's capacity to put more construction in place has been suppressed by a dearth of available carpenters, glaziers, ironworkers, roofers, superintendents, electricians, etc.

It is also conceivable that the sharp increase in construction materials prices that characterized the early months of 2018 resulted in the postponement of certain projects, translating into truncated spending later in the year. But with the pace of growth in construction materials prices moderating sharply during the second half of 2018, more of these projects may come back online, positioning 2019 as another solid one from the perspective of demand for construction services.

Contractors certainly expect to be busy. Between January 2018 and January 2019, construction firms collectively added 338,000 jobs to their payrolls in anticipation of ongoing demand. This pace of job growth is simply astonishing given how difficult it has been to fill available jobs.

Indeed, data from the BLS's Job Openings and Labor Turnover Survey (JOLTS) indicate that demand for construction workers continues to drift higher. According to the most recently available data, there were 7.3 million job openings across all industries in December 2018, the highest level recorded since BLS began measuring such things. During that month, there were 6.3 million unemployed workers, which translates into 1.2 available jobs for each person looking for work. Construction contributed to the job openings tally in a meaningful way, with 88,000 new job openings registered that month. This means that construction by itself comprised 44 percent of the 198,000 net new job openings associated with private employers for the month.

Other data, including survey data, also indicate strong demand for construction workers. The Associated General Contractors (AGC) published its 2019 Construction Outlook Survey at the beginning of the new year. Among other things, contractors were asked about what they considered the leading threat to their future. Thirty percent of respondents listed labor shortfalls as their top concern, ranking first on the list. To put that into perspective, "increased competition for projects" was a distant second with only 10 percent. The same survey noted that almost 80 percent of respondents plan to expand their workforce in the coming year.

Exhibit 3. *Construction Employment Growth, 20 Largest U.S. Metropolitan Areas Dec. 2017 v. Dec. 2018, Not Seasonally Adjusted*

Rank	MSA	% Change	Rank	MSA	% Change
1	Phoenix-Mesa-Scottsdale, AZ	13.7%	11	Washington-Arlington-Alexandria, DC-VA-MD-WV*	4.3%
2	Dallas-Fort Worth-Arlington, TX*	10.5%	12	San Francisco-Oakland-Hayward, CA	3.7%
3	Miami-Fort Lauderdale-West Palm Beach, FL	9.8%	13	New York-Newark-Jersey City, NY-NJ-PA*	3.6%
4	Detroit-Warren-Dearborn, MI*	9.7%	14	Seattle-Tacoma-Bellevue, WA	3.4%
5	Houston-The Woodlands-Sugar Land, TX	8.8%	15	Chicago-Naperville-Elgin, IL-IN-WI	2.4%
6	Atlanta-Sandy Springs-Roswell, GA	8.5%	16	Baltimore-Columbia-Towson, MD*	-0.3%
7	Philadelphia-Camden-Wilmington, PA-NJ-DE-MD*	7.0%	17	Los Angeles-Long Beach-Anaheim, CA	-0.6%
8	Boston-Cambridge-Nashua, MA-NH*	6.5%	18	Riverside-San Bernardino-Ontario, CA	-1.3%
9	Tampa-St. Petersburg-Clearwater, FL	5.1%	19	St. Louis, MO-IL*	-1.7%
10	Minneapolis-St. Paul-Bloomington, MN-WI*	4.5%	20	San Diego-Carlsbad, CA	-2.3%

Source: U.S. Bureau of Labor Statistics

The Associated Builders and Contractors (ABC) publishes its Construction Confidence Index (CCI) every quarter. The most recent survey indicates that coming into 2019, construction industry leaders felt confident about the near-term, at least in the nonresidential construction sector. Roughly two-thirds of survey respondents indicate that they expect sales to increase during the months ahead. Nearly half of respondents expect profits to grow during 2019's initial half even in the face of rising labor costs.

Naturally, some sections of the nation are more likely to sustain large-scale construction worker shortages than others. Based on regional economic growth, these issues are likely to be most acute in the South and the West as markets like Orlando, Phoenix, Houston, Seattle, and Dallas continue to add jobs in large numbers. That said, job growth is apparent throughout metropolitan America, including in large Midwestern markets like Detroit and St. Louis.

Could Inflation End the Construction Expansion Cycle?

In a word, yes. But to date, inflation has remained constrained. That has translated into stubbornly low interest rates, which in turn has translated into favorable cost of capital for investors and ongoing support for new projects. The most recent reading of the core Consumer Price Index suggests that inflation has been running at a 2.1 percent pace. The Federal Reserve's preferred measure is the Core PCE (personal consumption expenditures) Deflator, which indicates inflation running at a 1.9 percent pace. This is below the Federal Reserve's 2.0 percent target. In other words, even after more than nine years of economic expansion and with the nation's unemployment rate recently achieving a near 50-year low, inflation has not yet become problematic.

The Federal Reserve ended its zero interest rate policy (ZIRP) in 2015 when it began raising interest rates under then-Federal Reserve Chair Janet Yellen. As of this writing, the Fed has raised rates nine times since December 2015, with the last hike in December 2018. As recently as late 2018, key Federal Reserve officials appeared ready to further hike rates, but more recent pronouncements suggest a pause in rate hikes. That's good for real estate and construction, at least in the near-term.

National Economic Overview

In late 2017, economists and others were justifiably confident regarding 2018's prospects. Financial markets performed brilliantly in 2017, with U.S. equity values rising and the economy posting 2.2 percent growth. With federal tax cuts passed in late 2017, the presumption was that the U.S. economy would flourish in 2018.

That's precisely what happened. Recent data from the Bureau of Economic Analysis indicate that the domestic economy expanded 2.9 percent last year. The year started off strong. For instance, during 2018's initial three months, the economy added 228,000 net new jobs per month on average, according to the Bureau of Labor Statistics (BLS). Quarterly GDP came in at a 2.2 percent annualized rate during last year's first quarter.

Then things got better. Despite growing difficulty finding new workers in construction, manufacturing, logistics, healthcare, hospitality, and other segments, the U.S. economy added 248,000 jobs per month on average during 2018's second quarter. A surge of business investment traceable in part to tax reform allowed the economy to expand 4.2 percent on an annualized basis during the quarter, which would turn out to be the year's strongest.

The impressive rate of growth persisted into and through the third quarter, with the economy expanding 3.6 percent on an annualized basis. Still, there were some signs of deterioration in performance, with business investment slowing a bit and average monthly job growth dipping to 189,000. There was even more evidence of economic slowing in much of the balance of the world, with Italy entering recession, Germany barely missing one, and emerging nations such as Venezuela, Argentina, Turkey, South Africa, and China sending aloft a growing chorus of concern. China is the world's second largest economy and registered its slowest rate of growth in 28 years in 2018.

Despite that, the U.S. economy managed to end the year in reasonably strong fashion, at least from the perspective of output growth. Fourth quarter GDP came in at 2.6 percent on an annualized basis. However, financial markets turned volatile, with steep losses registered in the Dow Jones Industrial Average, S&P 500, and the NASDAQ. After reaching a record high of 28,828 on October 4, 2018, the Dow began a lengthy skid, including falling by 800 points just four days later. By October's end, the Dow was off nearly 2,000 points, effectively erasing gains garnered earlier in the year.

Still, the broader economy continued to perform, with 277,000 jobs added last October, another 196,000 in November, and 222,000 to close out the year. That translates into an impressive 232,000 net new jobs per month on average during 2018's final quarter, reminding each of us that the economy is not the stock market, and the stock market is not the economy.

By the end of last year, America was just seven months from sustaining the lengthiest recovery in American history. As of this writing, the nation has added jobs for 100 consecutive months, an unrivaled winning streak. Over those 100 months, the nation has added more than 20 million net new jobs.

Warning Signals Emerge

Though 2019 looks poised to be a good year for contractors, a handful of ominous indicators have emerged suggesting that the next downturn is perhaps just beyond the horizon. Among these is the financial market volatility that returned late last year, the partial inversion of the yield curve (a favorite indicator of impending economic slowing or recession among many economists), and the fact that the unemployment rate remains below the so-called natural rate of unemployment. That latter circumstance prevailed before the recessions of the early 1980s, the recession of the early 1990s, the 2001 recession, and the 2007-2009 downturn.

There is also evidence of a weakening U.S. industrial sector, in part due to softening global growth and a strong U.S. dollar. The ISM Manufacturing Index dipped to 54.1 in December, its lowest reading in more than two years. While any reading above 50 indicates ongoing growth, a number of sub-indicators, including new orders, exhibited a rapid rate of deterioration.

Small business confidence has also been sinking of late, including with respect to expectations for capital investment. After the tax cut passed late in 2017, business capital spending surged during 2018's initial half, but was considerably more sluggish during the second half of the year. Falling small business confidence suggests that business capital spending may not strengthen over the near-term, leaving the economy increasingly dependent on consumer outlays as a driver.

It should also be noted that indebtedness is at an all-time high. Nominally, consumer debt has never been higher. The same is true for both corporate debt and the national debt, which recently raced past the $22 trillion mark. All of this serves as a source of growing vulnerability even as strong economic growth appears all but assured in the near-term.

Looking Ahead

Many economists continue to forecast an economic downturn in 2020 or 2021, but few can point to a likely triggering event. While economists like to say things like "economic recoveries don't die of old age," many economists seem to believe that the time for the next downturn has come.

There are many risks, including a trade war with China, sharp declines in asset prices, and a sudden spike in interest rates should inflation data become less benign. However, there are also outcomes that could serve to further strengthen economic performance and extend the current expansion. Among these is a trade deal with China; the cessation of tariffs on steel, aluminum, and softwood lumber (which would be deflationary or disinflationary and would help keep interest rates low); a federal infrastructure package; and further indications that the Federal Reserve is in fact on the sidelines for now.

Perhaps the more likely outcome is that rising inflationary pressures will eventually become apparent (it hasn't happened yet). That will drive borrowing costs higher and certain asset prices lower, which will trigger the next economic downturn. Already, there is evidence of softening global economic growth, weakening U.S. industrial production, slackening small business investment, softer home price appreciation, and increasingly sluggish auto sales. Many economists expect this nascent economic weakness to broaden as 2019 proceeds, but we are fully open to the possibility that these expectations are misguided and that the current economic expansion could persist into and beyond 2021 given the right set of policy outcomes.

Fourth Quarter 2018 Performance		Values		% Change from	
Gross Domestic Product (Quarterly % Growth)	**2018Q4[1]**	**2018Q3**	**2018Q2**		
Overall Real GDP	2.6%	3.4%	4.2%	NA	NA
Nonresidential Fixed Investment in Structures	6.2%	2.5%	8.7%	NA	NA
Construction Spending, SA [2] ($Millions)	**Dec-18**	**Nov-18**	**Dec-17**	**Nov-18**	**Dec-17**
Total Construction	$1,292,717	$1,300,559	$1,272,639	-0.6%	1.6%
Residential	$542,178	$550,027	$550,619	-1.4%	-1.5%
Nonresidential	$750,540	$750,532	$722,020	0.0%	4.0%
Lodging	$33,578	$33,253	$30,239	1.0%	11.0%
Office	$74,835	$74,253	$69,152	0.8%	8.2%
Commercial	$86,188	$86,807	$89,061	-0.7%	-3.2%
Health care	$41,360	$41,052	$43,304	0.8%	-4.5%
Educational	$98,462	$99,016	$93,150	-0.6%	5.7%
Religious	$3,028	$3,091	$2,977	-2.0%	1.7%
Public safety	$9,335	$9,276	$8,886	0.6%	5.1%
Amusement and recreation	$27,088	$27,403	$25,127	-1.1%	7.8%
Transportation	$53,088	$53,875	$50,000	-1.5%	6.2%
Communication	$24,964	$23,872	$25,243	4.6%	-1.1%
Power	$98,838	$99,008	$91,766	-0.2%	7.7%
Highway and street	$89,482	$90,220	$87,917	-0.8%	1.8%
Sewage and waste disposal	$22,058	$22,150	$21,105	-0.4%	4.5%
Water supply	$13,041	$13,083	$12,019	-0.3%	8.5%
Conservation and development	$7,467	$7,554	$7,580	-1.2%	-1.5%
Manufacturing	$67,727	$66,618	$64,496	1.7%	5.0%
Employment, SA (in thousands)	**Dec-18**	**Nov-18**	**Dec-17**	**Nov-18**	**Dec-17**
National Total Nonfarm	150,275	150,048	147,596	0.2%	1.8%
Construction	7,400.0	7,384.0	7,093.0	0.2%	4.3%
Residential building	824.7	822.0	773.4	0.3%	6.6%
Nonresidential building	825.0	826.1	804.4	-0.1%	2.6%
Heavy and civil engineering construction	1,075.4	1,071.7	1,008.8	0.3%	6.6%
Residential specialty trade contractors	2,046.7	2,050.3	1,981.9	-0.2%	3.3%
Nonresidential specialty trade contractors	2,627.8	2,613.5	2,524.2	0.5%	4.1%
Producer Price Index [3], NSA	**Dec-18**	**Nov-18**	**Dec-17**	**Nov-18**	**Dec-17**
Finished Goods (SA)	115.1	115.4	113.2	-0.3%	1.7%
Inputs to Construction Industries	228.1	232.0	220.3	-1.7%	3.5%
General Contractors (New Nonresidential Building Const.)	112.0	111.7	107.0	0.3%	4.7%
New Nonresidential Building Construction (U.S.)	113.0	113.0	107.4	0.0%	5.2%
Northeast	113.4	113.5	108.1	-0.1%	4.9%
South	112.8	112.8	107.3	0.0%	5.1%
Midwest	110.6	110.3	105.4	0.3%	4.9%
West	115.1	115.1	108.5	0.0%	6.1%

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

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