MARCUM Commercial Construction Index

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The Arguably Better, the Not So Bad, and the Downright Scary

By Anirban Basu, *Chief Construction Economist, Marcum LLP*

What's Better

Construction Continues to Recover Lost Jobs

After two months of monumental job losses in March and April, the construction industry experienced historical job gains as 2020 approached its departure. The first two months of the pandemic witnessed the elimination of 1.1 million construction jobs. Between May and October, the industry recovered 73 percent of those lost positions. The construction unemployment rate, which rose from 5.5 percent in February to 16.6 percent in April, was down to 6.8 percent by October, the latest month for which these data are available. No major sector of the economy has recovered a higher proportion of its early-stage pandemic job losses as construction.

The numbers are not quite as positive for nonresidential contractors, however. Much of the construction industry's momentum pertains to a surge in homebuilding. For a variety of reasons, the single-family housing market has emerged as one of America's leading economic drivers. While mortgage rates were low as the pandemic approached, they have fallen further since, inducing many people to begin thinking about homeownership.

There's more. The pandemic has increased the desirability of social distancing and persuaded many people that they need enough space and spatial segmentation for a home office. Apartments often don't offer that type of space; homes often do. With the bulk of purchasing opportunities available in America's suburbs, the general direction of migration has been out of cities and into their surrounding environments.

But's that not where the story ends. Demographics are also supportive. During the prior decade, many Millennials, often defined as those born between 1980 and 1996, moved into America's largest cities. Having watched the Great Recession tear through the economy, they chose larger cities not only for reasons of lifestyle, but to be immersed in America's deepest labor markets to maximize job security. Many of these young people moved into newly constructed apartments, frequently associated with lofty rents. But many of these Millennials are now in their 30s while another large group is in their late-20s. Correspondingly, the time has come for many to shift from rental status to owner occupancy.

The implication is that the construction jobs numbers are not necessarily reflective of nonresidential construction's performance. That said, nonresidential construction employment has also been in recovery, though the pace of recovery has been softer than that observed in the single-family building market.

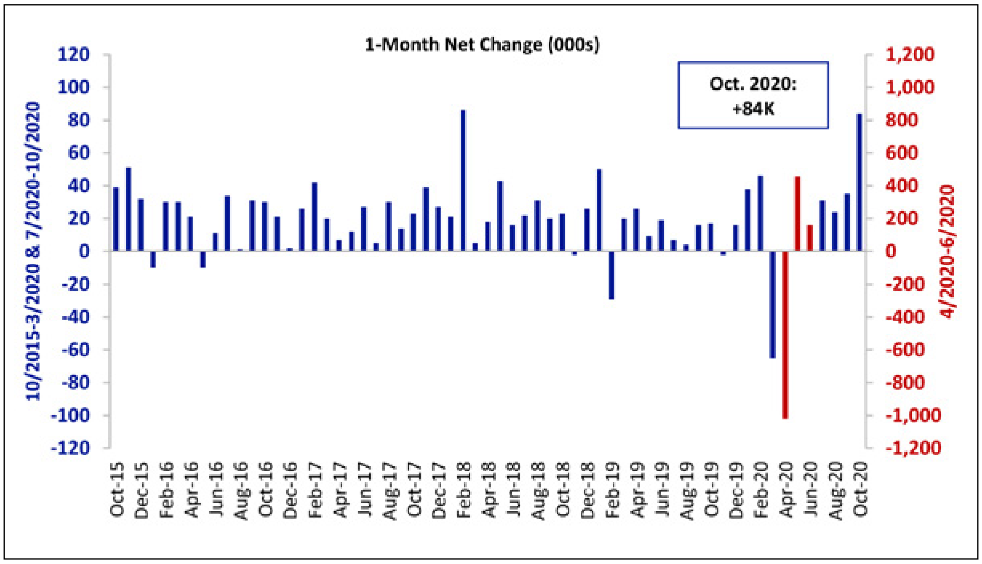
Joe's View

It has been a long journey from the beginning of the pandemic until now and, I fear, we are not yet at its end. Many factors are at play, which will influence the future of nonresidential construction in ways we cannot predict. However, when you read this quarter's Index, one thing is clear. The construction Industry is a job creator for America. Ours is a resilient and (truly) essential function of the economy, our national infrastructure, and the landscape of our great country. Work-from-home, lock downs and cut-backs are beyond our control, but I am comfortable predicting one thing: the world will always need our skilled labor force, our tradespeople. So, in this time of uncertainty, here's something we can do to improve our collective future. In whatever way you see fit, let's double down on trade education in America. Let's encourage young people to explore developing those essential skills (with or without a college degree), and let us create opportunities and access for our mature workforce to acquire new skills for this coming new world.

Have a happy and healthy holiday season.

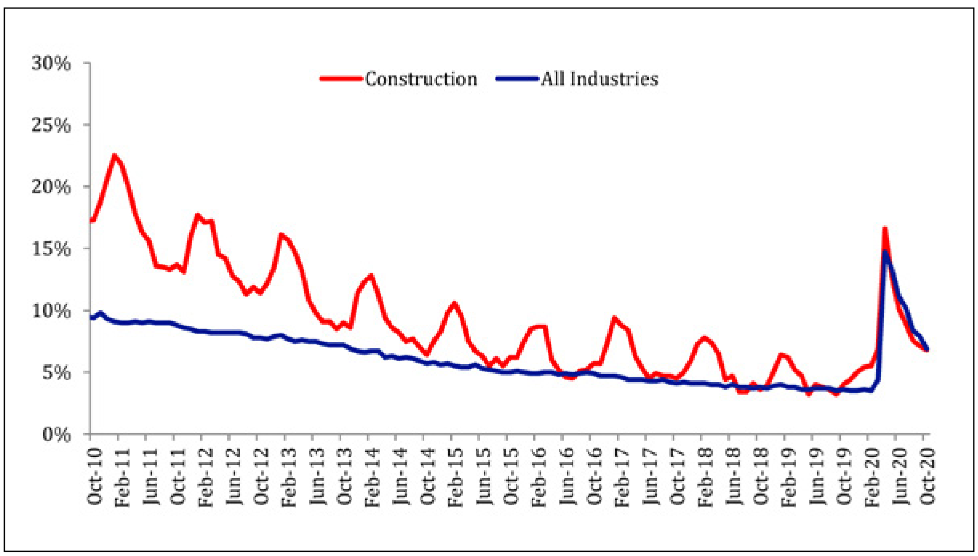
Joseph Natarelli, CPA
National Construction Industry Group Leader, Marcum LLP

Exhibit 1. *Monthly Change in Construction Employment, October 2015 – October 2020*



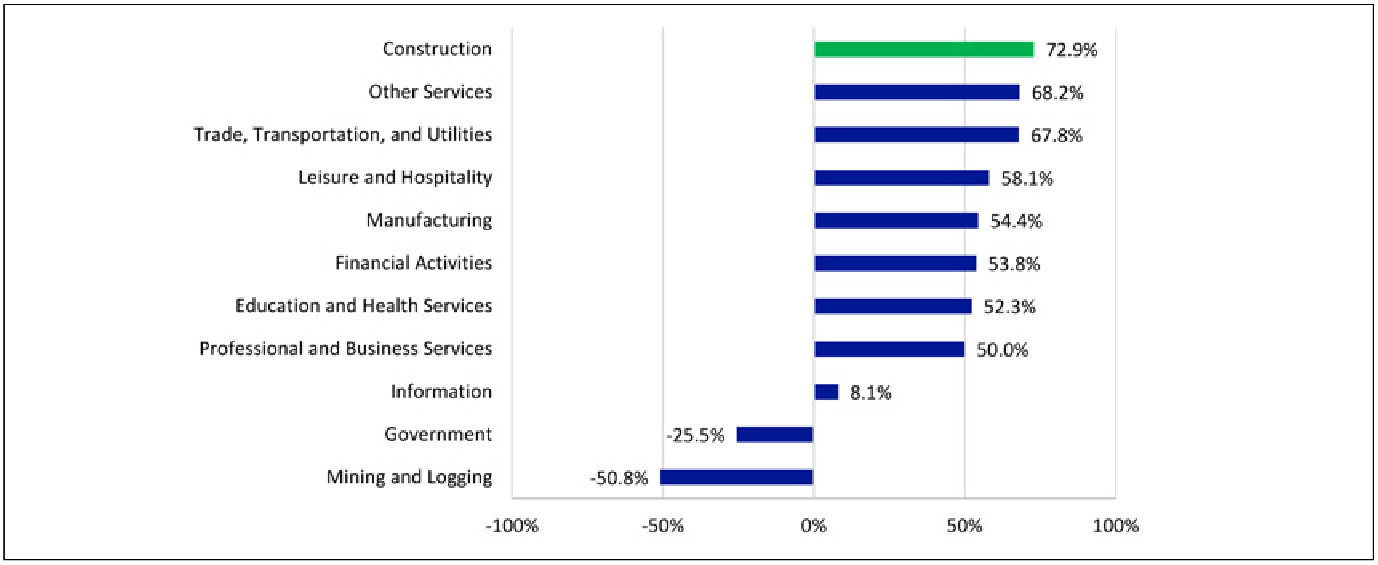
Source: U.S. Bureau of Labor Statistics; Note: Because of the magnitude of the job losses/gains, figures for April 2020, May 2020, and June 2020 are presented on the right axis.

Exhibit 2. *Unemployment Rate: Construction vs. All Industries, October 2010 – October 2020*



Source: U.S. Bureau of Labor Statistics. Note: SA-Seasonally Adjusted; Note: Construction unemployment is not seasonally adjusted.

Exhibit 3. *Percentage of Jobs Recovered Following the Economic Shutdown, as of October 2020*



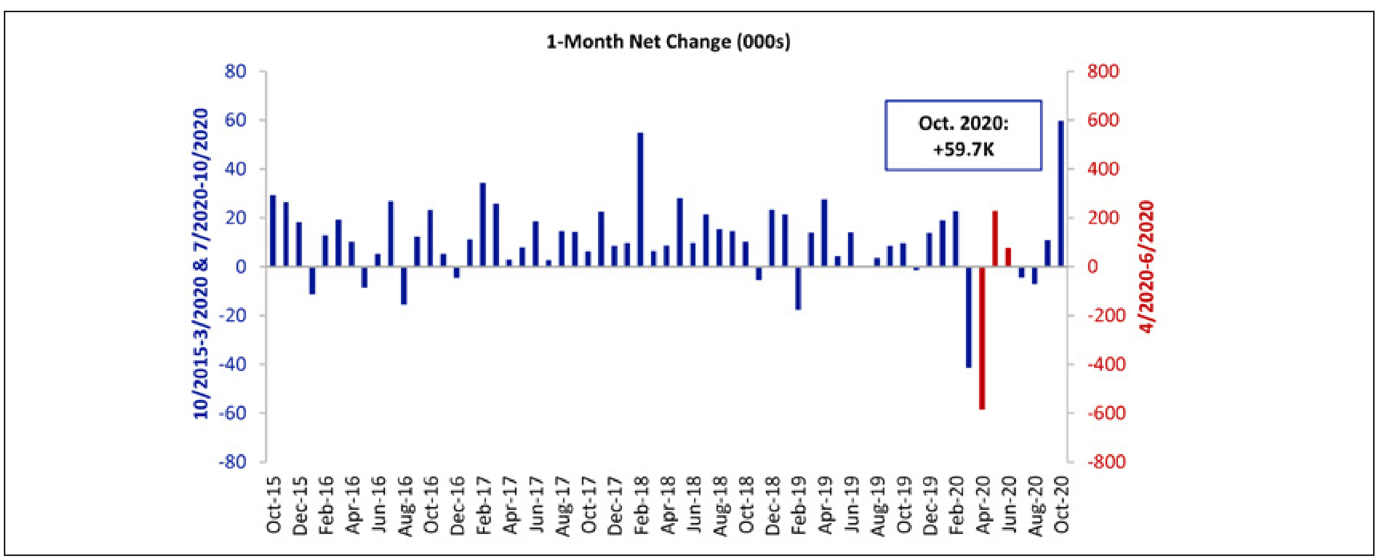
Source: U.S. Bureau of Labor Statistics; Note: These values were calculated by taking the total number of jobs added between May 2020 and September 2020 and dividing by the absolute value of jobs lost in March and April 2020.

Nonresidential Construction Employment Expands in Fits and Starts

Nonresidential construction employment, which consists of the nonresidential building, heavy and civil engineering, and nonresidential specialty trade contractor segments, rebounded in October according to the latest data from the U.S. Bureau of Labor Statistics. After losing a combined 11,000 jobs in July and August, the sector posted back-to-back months of positive employment growth, adding 10,800 positions in September followed by 59,700 jobs in October. Through October, nonresidential construction had recovered 58 percent of the jobs lost in March and April.

Despite tighter lending conditions, negatively impacted state and local government finances and deteriorating commercial real estate fundamentals, nonresidential construction experienced job creation in each of its three major segments in October. Nonresidential specialty trade contractors experienced the largest gain, adding 27,500 jobs, followed by heavy and civil engineering, which added 18,800 positions, and nonresidential building, which added 13,400 jobs. That said, there is still much ground to be made up. A year ago, nonresidential construction employed nearly 208,000 more people than it does today.

Exhibit 4. *Monthly Change in Nonresidential Construction Employment, October 2015 – October 2020*



Source: U.S. Bureau of Labor Statistics; Note: 1. Nonresidential Construction consists of the following subsectors: nonresidential building, heavy and civil engineering, and nonresidential specialty trade contractors. 2. Because of the magnitude of the job losses/gains, figures for April 2020, May 2020, and June 2020 are presented on the right axis.

Economy Bounces Back in the 3rd Quarter

According to data from the U.S. Bureau of Economic Analysis, the U.S. economy expanded at an annualized rate of 33.1 percent in the third quarter of 2020, bouncing back after the historic drop the previous quarter. Nonresidential fixed investment increased at an annualized rate of 20.3 percent for the quarter, though investment in structures declined 14.6 percent.

Few economists had anticipated as sharp a rebound as has transpired, in part because too many have tried to compare the current economic crisis with the one that swept over the world in 2008-09. That prior downturn was a demand shock as liquidity and capital dried up. Once that happens, it takes time (many years) for confidence to rebound, including among investors.

But the prime mover in the current period was a supply shock as economic lockdowns and social distancing measures were implemented. Economists who understood this as a supply shock quickly realized that the early stage recovery would be brisk, and it has been.

Here's the problem for contractors and other economic stakeholders. The pandemic is still with us. Already, there are hospitals overwhelmed by the volume of COVID-19 patients. As people are driven further indoors by the colder temperatures of November, December, January and February, further acceleration of infection spread appears likely. That will trigger even more economic lockdowns, potentially sending the economy back into recession.

That means that the "v-shaped" recovery that has been observed thus far could turn into a "w". For contractors, among the keys to managing the winter months is to be especially careful with cash, to continue to communicate with their bankers and insurers, and to thread the needle between bidding too loftily on available projects (competition for work is fierce) and bidding with insufficient margins and contingencies.

The Not So Bad

Materials Prices Have Been Well-Behaved for the Most Part, but That Could Change

Rising materials prices represent yet another risk facing nonresidential contractors going forward. Many contractors have expressed concern that global supply chain disruptions would produce a combination of materials shortages and rising prices. Indeed, many contractors have reported occasional issues procuring necessary inputs to production, further slowing construction service delivery. But in general, materials prices have not raced higher as feared, with the noteworthy exception of softwood lumber.

That may be changing, however. Materials prices expanded nearly 2 percent in September and are now higher than they were at the same time last year. Despite the lingering pandemic, the global economy has been recovering, increasing demand for key commodities. Rapid viral spread, including in Europe and parts of North America, render materials shortages more likely during the winter months. Were Congress to pass a stimulus package under current conditions, especially one offering a meaningful infrastructure component, materials prices could rise even faster.

Fears of persistently rising materials prices, however, may be overblown. For now, Congress is not focused on passing a near-term stimulus, dealing with the aftermath of a contested election. The pace of economic expansion has been softening recently, and the global economy is poised to slow during the winter months as economic shutdowns re-emerge. All of this suggests potentially softening demand for construction materials during the months ahead, which would help to suppress rapid price increases over the short-term.

The Downright Terrible

Nonresidential Construction Braces for Impact

Recession or not, nonresidential construction is the weakest it has been in more than a decade. Commercial real estate has been hit particularly hard, with industry fundamentals in tatters as more people work remotely, more retailers go bankrupt, and hotels remain under-occupied.

Two University of Chicago economists recently determined that 37 percent of jobs can be done entirely from home. But the fact that many people can work from home was well understood prior to the crisis. What is more remarkable are the recent studies indicating that many people are more productive working from home than in the office.

This is not particularly good news for office construction. Over the past decade, one associated with persistent growth and falling unemployment rates, many firms upgraded their office accommodations by moving from Class B to Class A/A+ space. This was done for a variety of reasons, including location and prestige. It was also done as a way to recruit talent and retain skilled workers by placing them in more appealing settings. But with unemployment elevated and the Classes of 2020 and 2021 looking at the worst employment markets since at least 2009, many firms may eschew expensive space for less luxurious options, including in the suburbs, many of which are associated with elevated vacancy rates. The aggregate demand for space among many users will also ratchet lower as they seek to minimize real estate costs.

Nonresidential Construction Spending is Trending Lower

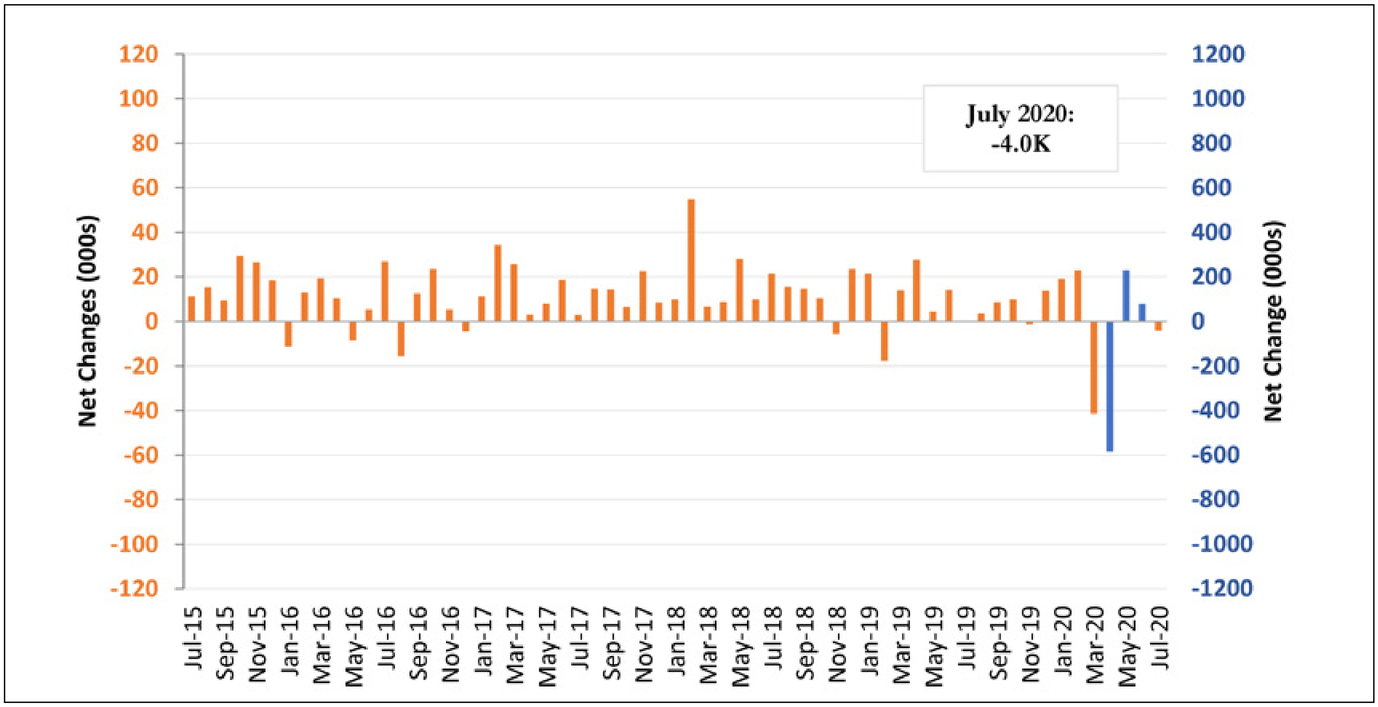
According to the latest data from the U.S. Census Bureau, the rate of decline in nonresidential construction spending is accelerating. This isn't surprising. Prior to the recession, the economy was booming, helping to pad construction backlog, especially in the context of elevated developer confidence and a low cost of capital. The pandemic brought this near-perfect dynamic to a halt, ushering in a slew of problems for the industry. These include diminished commercial real estate fundamentals, suppressed investor confidence, delayed or outright cancelled projects, increased remote work, tighter credit markets, and ravaged state and local government budgets.

Though the early months of the recovery have been robust, these trends are unlikely to continue in the months ahead if Washington fails to provide additional stimulus. This would further delay nonresidential construction's eventual recovery.

As it is, nonresidential spending is down 4.4 percent on a year-over-year basis through September. Some spending subcategories are faring considerably worse than others, including lodging, which is off more than 15 percent, and office, down nearly 7 percent.

The hope is that policymakers in Washington, D.C., will soon see fit to deliver on a long-awaited infrastructure financing and spending program. Not only would that accelerate the broader economy's recovery, a well-executed infrastructure package would make American workers more productive, unleash new private development opportunities and allow America to better compete in the global marketplace. The longer America has to wait for such a package, the more vulnerable its citizens will be to further economic dislocation.

Exhibit 5. *Nonresidential Construction Spending by Subsector, September 2020 Y-o-Y change*



Source: U.S. Census Bureau

There are some bright spots. One segment that has benefited from the shutdowns and social distancing measures is e-commerce. The backbone of these online retailers are fulfillment and data centers as well as trucking. E-commerce will be a source of significant construction starts for years to come.

There are also opportunities associated with the post-pandemic world. As many businesses look to cut costs, there may be an increase in demand for Class B office space, incentivizing property managers to update and renovate those facilities. HVAC contractors are especially well positioned as owners look to upgrade air handling systems to limit viral spread. Other likely improvements will focus on shared spaces such as elevators, restrooms, and lobbies.

Looking Ahead

While many recent economic metrics provide reasons for optimism, contractors should remain on guard. Another recession is probable as COVID-19 rages across the nation, driving up hospitalizations and inducing governors, mayors, and others to reimpose social distancing directives. The "V" is set to become a "W." The good news is that much of 2021 could be spectacular for the broader economy as post-election stimulus potentially synergizes with a vaccine. Such dynamics would set the stage for powerful nonresidential construction spending recovery in 2022 and/or 2023.

Third Quarter 2020 Performance	Values			% Change from	
Gross Domestic Product (% Growth, SAAR)	**2020Q3[1]**	**2020Q2**	**2019Q3**		
Overall Real GDP	-33.1%	-31.4%	2.6%	NA	NA
Nonresidential Fixed Investment in Structures	-14.6%	-33.6%	3.6%	NA	NA
Construction Spending, SA ($Millions)	**Sep-20**	**Aug-20**	**Sep-19**	**Aug-20**	**Sep-19**
Total Construction	$1,414,027	$1,410,438	$1,393,304	0.3%	1.5%
Residential	$619,761	$603,239	$562,791	2.7%	10.1%
Nonresidential	$794,266	$807,199	$830,512	-1.6%	-4.4%
Lodging	$27,893	$28,353	$32,951	-1.6%	-15.4%
Office	$80,985	$81,140	$86,747	-0.2%	-6.6%
Commercial	$81,330	$82,894	$80,838	-1.9%	0.6%
Health care	$47,059	$47,155	$45,924	-0.2%	2.5%
Educational	$102,768	$101,209	$107,995	1.5%	-4.8%
Religious	$3,058	$2,980	$3,233	2.6%	-5.4%
Public safety	$14,649	$15,506	$11,026	-5.5%	32.9%
Amusement and recreation	$26,396	$27,043	$28,505	-2.4%	-7.4%
Transportation	$57,325	$57,721	$58,420	-0.7%	-1.9%
Communication	$22,485	$22,858	$22,430	-1.6%	0.2%
Power	$115,094	$117,762	$121,592	-2.3%	-5.3%
Highway and street	$89,543	$94,796	$95,808	-5.5%	-6.5%
Sewage and waste disposal	$26,826	$26,713	$28,577	0.4%	-6.1%
Water supply	$18,880	$19,029	$16,884	-0.8%	11.8%
Conservation and development	$7,671	$8,277	$9,379	-7.3%	-18.2%
Manufacturing	$72,304	$73,762	$80,204	-2.0%	-9.8%
Employment, SA (in thousands)	**Oct-20**	**Sep-20**	**Oct-19**	**Sep-20**	**Oct-19**
All Industries	142,373	141,735	151,553	0.5%	-6.1%
Construction	7,345	7,261	7,541	1.2%	-2.6%
Residential building	835	829	830	0.7%	0.7%
Nonresidential building	810	796	841	1.7%	-3.7%
Heavy and civil engineering construction	1,028	1,009	1,085	1.9%	-5.3%
Residential specialty trade contractors	2,099	2,081	2,093	0.9%	0.3%
Nonresidential specialty trade contractors	2,574	2,546	2,693	1.1%	-4.4%
Producer Price Index, NSA [2]	**Sep-20**	**Aug-20**	**Sep-19**	**Aug-20**	**Sep-20**
Finished Goods (SA)	114.0	113.5	115.1	0.4%	-1.0%
Inputs to Construction Industries	233.1	229.4	230.5	1.6%	1.1%
General Contractors (New Nonresidential Building Const.)	117.9	118.0	115.8	-0.1%	1.8%
New Nonresidential Building Construction (U.S.)	119.0	119.2	116.9	-0.2%	1.8%
Northeast	119.8	120.5	117.3	-0.6%	2.1%
South	119.7	119.5	116.3	0.2%	2.9%
Midwest	114.1	114.5	114.4	-0.3%	-0.3%
West	121.6	121.7	119.5	-0.1%	1.8%

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.*

[3] *SA: Seasonally Adjusted. NSA: Not Seasonally Adjusted. SAAR: Seasonally Adjusted Annual Rate*

Construction Services

Marcum LLP is a premier provider of full service accounting, tax and consulting services to the construction industry. Our clients range from small contractors to billion dollar international construction organizations. Our client base gives us the breadth and depth of construction experience to effectively and efficiently develop the strategies needed to meet your requirements.

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- SSAE 16 audits
- Internal audits
- Pension & benefit plan review & audits (ERISA)
- Financial forecasts & projections
- Internal controls review & design
- Due diligence on acquisitions/ divestitures
- Custom assurance services
- Mergers & acquisitions
- Operational auditing
- Accounting outsourcing
- Monitoring

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- Long-term construction contracts
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- Look-back planning & compliance
- Cost allocation
- Federal, state & local tax planning
- Estate & succession planning
- IRS examination assistance
- Tax preparation for owners & businesses
- Tax compliance and planning
- Planning for long term contract tax regulations

Consulting Services

- Surety credit & bank financing assistance
- Valuation services
- Business acquisition and sale
- Forensic accounting
- Fraud investigations
- Litigation support/expert testimony
- Claims consulting
- Strategic planning & profit enhancement

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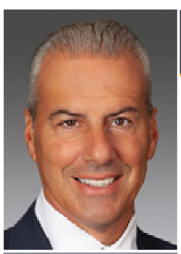
- Opening and maintaining bank accounts
- Setting up client access to accounts
- Reviewing proof of claims and determining correct payments
- Looking beyond the payment required
- Writing and processing checks with signatures
- Identification of fraudulent and preferential transfers and payments
- Returning undistributed funds
- Accounting and internal control assessment
- Performing monthly bank reconciliations
- Fraud investigation
- Escrow agent
- Paying agent

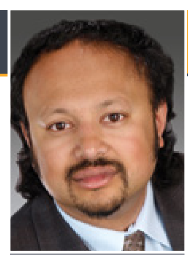
Surety Bond Investigations Services

- Financial analysis of principal
- Claims evaluation/ administration
- Indemnity investigations/ sources of recovery
- Monitoring project progress/ cost estimates
- Litigation support/principal tax issues
- Administration of trust/ escrow accounts
- Cash flow analysis
- Underwriting support



Joseph Natarelli

Joseph Natarelli is national leader of Marcum's Construction Industry Group 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.



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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