MARCUM
Commercial Construction Index

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First Quarter Construction Update: The Good, (The Strictly Okay), The Bad, and The Ugly

By Anirban Basu, Chief Construction Economist, Marcum LLP

Heading into 2024, the economy appeared to be in an ideal position for interest rate cuts. Inflation had slowed markedly, from a 9.1% year-over-year pace of price increases in June 2022 to a 3.4% rate in December 2023, employers continued to add jobs at a healthy pace while the unemployment rate remained low, and consumers continued to spend, powering ongoing growth. At the start of January, most forecasters assumed the Fed would cut interest rates at least three times during 2024.

The year's first quarter has squashed any hopes of imminent interest rate cuts. Inflation has accelerated and now appears to be stickier than anticipated. Most forecasters now expect one rate cut at most in 2024, and not until the end of the year.

For the construction industry, higher-for-longer interest rates are an unwelcome development. But despite high borrowing costs and tight lending standards, not to mention other headwinds like labor shortages and weakness in certain sectors, the industry retained a surprising level of momentum through the first three months of 2024.

The Good

Manufacturing Construction

Manufacturing-related construction, powered by the CHIPS Act, the Inflation Reduction Act, and a broad-based movement to reshore capacity, continues to surge. Construction spending on manufacturing structures is up 184% over the past four years. Given the size of many of these projects and ongoing efforts to strengthen the nation's semiconductor, clean energy, and electric vehicles production capacity, the manufacturing-related construction segment will retain momentum through the entirety of 2024.

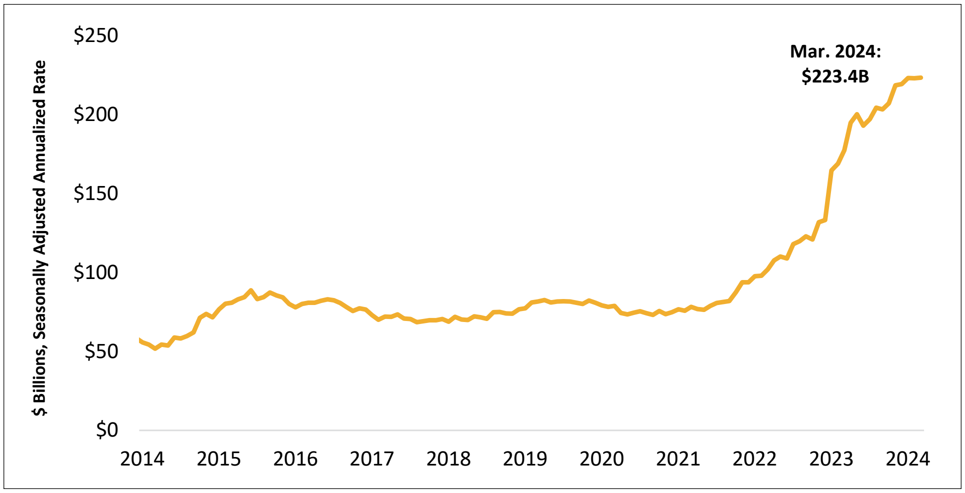
It's officially hurricane season in the Atlantic, and if you're a news junky like me, you've seen the local headlines dominated recently by stories of severe weather. It's a sobering sign of the times that some meteorologists are seriously proposing an update to the Saffir-Simpson scale, which measures hurricane strength, to better track the increasingly powerful storms we're seeing today.

For construction, that also means we have a job to do. While the residential construction market may be struggling now, I foresee a lot of homeowners demanding practical, weather resilient features on the horizon. After all, what's more important than the safety of our homes and families? As the increasing intensity of weather events introduces new demand for weather-proof solutions, our industry will need to embrace new methods and practices. Thankfully, we can take inspiration from communities that have thrived in extreme climates. In areas of the world at risk for flooding, ingenious solutions are incorporated into everyday structures, including buoyant tanks on buildings in Bangladesh, and elevated homes in Malaysia, India, and elsewhere.

It's just a matter of time until these and other climate mitigation features change the look of our communities. I can already picture a suburban U.S. development of the near future full of the cyclone-resistant, dome-style homes often seen in the typhoon-prone Philippines. My only question is: who will be the first to bring bold – and radically different – solutions like these to market?

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

Exhibit 1. Manufacturing-Related Construction Spending

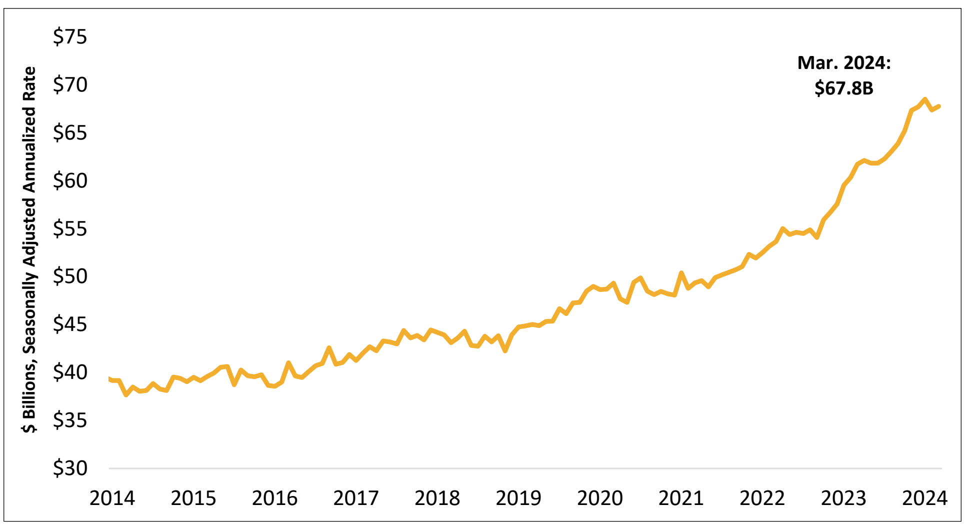


Source: U.S. Census Bureau; Note: Seasonally Adjusted

Healthcare Construction

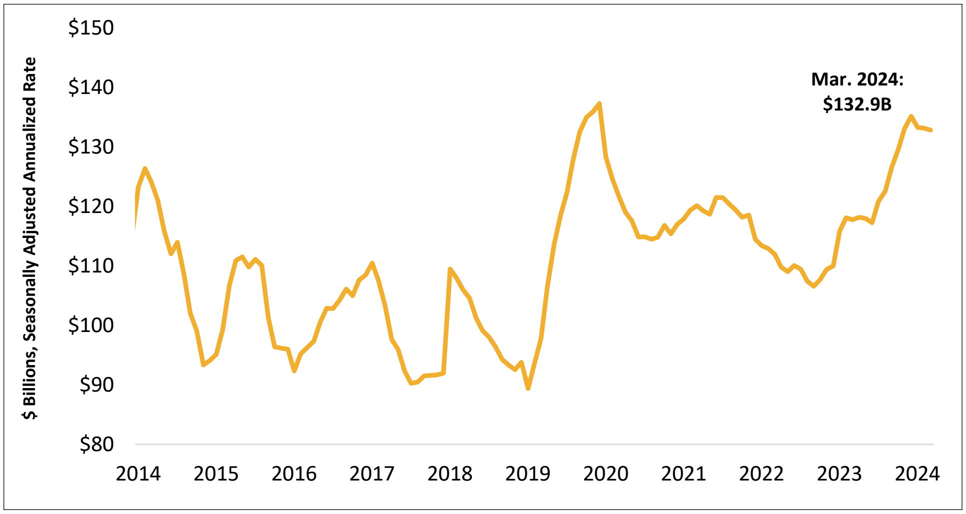
Construction spending in the healthcare segment was relatively flat during the first quarter, increasing just 0.1% through the first three months of the year. Despite this recent moderation, spending in the segment is up more than 26% over the past two years. This is largely due to rapidly increasing investment in outpatient facilities; construction spending on non-hospital medical buildings is up more than 100% since the start of the pandemic. Given the changing healthcare needs of an aging population, demand for new healthcare structures should remain firmly in place over the coming years.

Exhibit 2. Healthcare-Related Construction Spending



Source: U.S. Census Bureau; Note: Seasonally Adjusted

Exhibit 3. Power-Related Construction Spending



Source: U.S. Census Bureau; Note: Seasonally Adjusted

The Strictly Okay

Materials Prices

Construction input prices are up just 2.3% over the past year, a rate of increase significantly slower than economywide inflation. Unfortunately, a streak of tame input prices stretching back to early 2023 may be at an end.

Prices for inputs to construction increased sharply in April. This is partly due to global supply chain issues, with new bottlenecks arising in the Red Sea, the Panama Canal, and the Port of Baltimore. Global container shipping rates are up 113% since the end of January, according to the Freightos Baltic Index. While that's still 75% lower than the peak in late 2021, higher shipping costs will eventually put upward pressure on construction input prices.

Ongoing megaprojects across the nation will increase demand for certain inputs, driving those prices higher. That, along with the aforementioned supply chain disruptions and reemerging economywide inflation, suggests that input prices may continue to rise in the coming months.

Power-Related Construction

Construction spending in the power category, which encompasses oil, gas, and electric, declined by approximately 2% during the first quarter of 2024. Despite this recent decrease, spending in the category is up about 23% from the cyclical low in late 2022. Government funded projects, while a small part of total spending on power-related structures, will remain strong over the next several quarters.

Private sector spending, on the other hand, could exhibit less strength through the remainder of 2024. High interest rates, which now appear set to stay elevated for longer, and high material prices have caused the cancellation of a few massive offshore wind projects.

That said, ongoing efforts to modernize our electric grid should give the segment momentum over the coming years. Since 2019, construction spending on electric projects is up about 13%, while spending on gas-related projects is down 11% and spending on oil-related projects is down 88%.

Residential Construction

Residential construction spending declined by approximately 1% during the first quarter of 2024, but this is a tale of two subsegments. Construction of new single family homes increased 2% during the quarter and is up more than 18% over the past year, while spending on new multifamily units fell 2.3% for the quarter and is up less than 4% over the past year.

Multifamily construction boomed during the early years of the pandemic, with authorizations for new multifamily units soaring nearly 60% from the end of 2019 to the peak in the middle of 2022. The combination of tremendous new supply and severely elevated interest rates have since caused multifamily construction to fall sharply, yet authorizations for new multifamily units remain above the pre-pandemic level.

While single family construction has also slowed significantly from mid-2022 to early 2023, authorizations for new single family homes have since surged more than 30% and are back above the pre-pandemic level.

High interest rates will likely suppress residential construction throughout 2024, yet there is a structural shortage of housing units in the U.S. Homebuilders recognize this and will eventually move to expand supply.

Construction Employment & Labor Supply

The construction industry added jobs for the thirteenth straight month in April. Nonresidential building construction has added jobs at a particularly rapid pace lately, with employment in the category up 5.5% over the past year. That compares favorably to both the broader construction industry (up 3.2% year over year) and all industries (up 1.8%).

Unfortunately, this rapid employment growth has come at the cost of higher wages. Average hourly earnings for construction workers are up 5.2% over the past year, well above the 3.9% increase observed across all industries. Higher wages puts upward pressure on construction costs, exacerbating the effects of high interest rates and tight lending standards. Rapid wage growth is a symptom of ongoing labor shortages. Given demographic challenges for an aging workforce, these issues will likely remain in play for the foreseeable future.

Regionally, eight of the nation's 20 largest metro areas lost construction jobs over the twelve month period ending in March 2024. The Detroit metro area added jobs at the fastest pace, with several massive projects in downtown Detroit and several battery/electric vehicles projects throughout the area.

Exhibit 4. Construction Employment Growth, 20 Largest U.S. Metropolitan Areas, March 2023 v. March 2024

Rank	MSA	% Change	Rank	MSA	% Change
1	Detroit-Warren-Dearborn, MI*	10.7%	11	Houston-The Woodlands-Sugar Land, TX	1.1%
2	Miami-Fort Lauderdale-West Palm Beach, FL	5.6%	12	San Francisco-Oakland-Hayward, CA	0.2%
2	Riverside-San Bernardino-Ontario, CA	5.6%	13	Chicago-Naperville-Elgin, IL-IN-WI	-0.4%
4	St. Louis, MO-IL*	4.2%	14	Washington-Arlington-Alexandria, DC-VA-MD-WV*	-0.6%
5	Dallas-Fort Worth-Arlington, TX*	3.6%	15	New York-Newark-Jersey City, NY-NJ-PA*	-1.2%
6	Phoenix-Mesa-Scottsdale, AZ	3.2%	16	Boston-Cambridge-Nashua, MA-NH*	-1.3%
7	San Diego-Carlsbad, CA	3.1%	17	Philadelphia-Camden-Wilmington, PA-NJ-DE-MD*	-2.0%
8	Atlanta-Sandy Springs-Roswell, GA	3.0%	18	Baltimore-Columbia-Towson, MD*	-3.4%
9	Tampa-St. Petersburg-Clearwater, FL	1.7%	19	Seattle-Tacoma-Bellevue, WA	-4.4%
10	Los Angeles-Long Beach-Anaheim, CA	1.2%	20	Minneapolis-St. Paul-Bloomington, MN-WI*	-7.2%

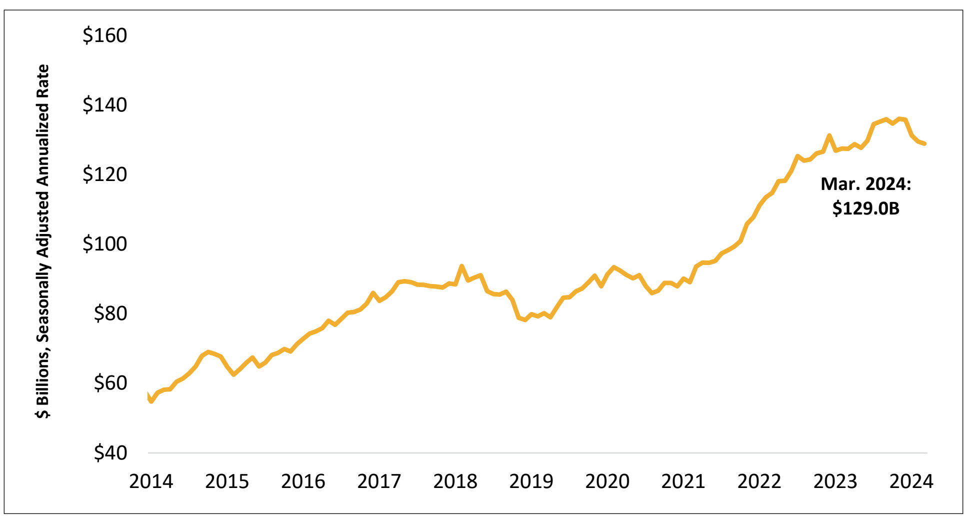
Source: U.S. Bureau of Labor Statistics ** Construction, Mining, and Logging are included in one industry*

The Bad

Commercial Construction

Commercial construction spending fell more than 5% during the first quarter of 2024. Warehouse construction, fueled by the expansion of eCommerce, has propped up construction spending in the segment over the past few years and accounted for well over half of all commercial construction spending in 2023. Unfortunately, warehouse investment appears to have leveled off. Weakness in retail construction, which has plummeted due to eCommerce and high interest rates, will continue to drag on the segment.

Exhibit 5. Commercial-Related Construction Spending



Source: U.S. Census Bureau; Note: Seasonally Adjusted

The Ugly

Inflation and Interest Rates

The construction industry has weathered roughly two years of elevated inflation and high interest rates better than anyone could have expected. With inflation accelerating throughout the year's first quarter, however, it now appears that interest rates are set to stay higher for longer. As a result, banks continue to tighten standards for construction loans. As project financing becomes increasingly difficult to secure, certain segments, including those not boosted by infrastructure or manufacturing-related federal programs, will struggle.

Exhibit 6

First Quarter 2024 Performance	Values			% Change from	
Gross Domestic Product (% Growth, SAAR)	**2024Q1[1]**	**2023Q4**	**2023Q3**		
Overall Real GDP	1.6%	3.4%	4.9%	NA	NA
Nonresidential Fixed Investment in Structures	-0.1%	10.9%	11.2%	NA	NA
Construction Spending, SA ($Millions)	**Mar-24**	**Feb-24**	**Mar-23**	**Feb-24**	**Mar-23**
Total Construction	$2,083,926	$2,087,792	$1,901,401	-0.2%	9.6%
Residential	$895,926	$902,496	$856,947	-0.7%	4.5%
Nonresidential	$1,188,000	$1,185,296	$1,044,454	0.2%	13.7%
Lodging	$22,619	$22,913	$22,744	-1.3%	-0.5%
Office	$101,638	$101,362	$94,772	0.3%	7.2%
Commercial	$128,955	$129,565	$127,474	-0.5%	1.2%
Healthcare	$67,773	$67,388	$61,749	0.6%	9.8%
Educational	$128,487	$127,355	$109,604	0.9%	17.2%
Religious	$3,948	$4,022	$3,243	-1.8%	21.7%
Public Safety	$17,411	$17,154	$11,910	1.5%	46.2%
Amusement and Recreation	$35,562	$35,175	$29,764	1.1%	19.5%
Transportation	$65,767	$66,028	$61,986	-0.4%	6.1%
Communication	$25,477	$25,410	$24,554	0.3%	3.8%
Power	$132,860	$133,207	$117,803	-0.3%	12.8%
Highway and Street	$150,057	$148,706	$125,071	0.9%	20.0%
Sewage and Waste Disposal	$42,810	$43,316	$38,707	-1.2%	10.6%
Water Supply	$29,502	$29,239	$25,220	0.9%	17.0%
Conservation and Development	$11,709	$11,393	$12,397	2.8%	-5.5%
Manufacturing	$223,429	$223,063	$177,457	0.2%	25.9%
Employment, SA (000s)	**Apr-24**	**Mar-24**	**Apr-23**	**Mar-24**	**Apr-23**
All Industries	158,286	158,111	155,484	0.1%	1.8%
Construction	8,219	8,210	7,961	0.1%	3.2%
Residential Building	950	947	923	0.3%	2.9%
Nonresidential Building	917	916	869	0.1%	5.5%
Heavy and Civil Engineering Construction	1,146	1,146	1,104	0.0%	3.8%
Residential Specialty Trade Contractors	2,407	2,409	2,359	-0.1%	2.1%
Nonresidential Specialty Trade Contractors	2,798	2,791	2,706	0.2%	3.4%
Producer Price Index, NSA [2]	**Apr-24**	**Mar-24**	**Apr-23**	**Mar-24**	**Apr-23**
Finished Goods (SA)	144.7	144.0	142.8	0.4%	1.3%
Inputs to Construction Industries	326.4	324.7	319.2	0.5%	2.3%
General Contractors (New Nonresidential Building Const.)	157.6	157.4	158.5	0.2%	-0.5%
New Nonresidential Building Construction (U.S.)	161.0	160.8	162.7	0.1%	-1.1%
Northeast	169.4	169.2	168.7	0.1%	0.5%
South	158.4	158.6	160.4	-0.1%	-1.2%
Midwest	153.0	153.3	153.6	-0.2%	-0.4%
West	165.5	164.5	169.3	0.6%	-2.2%

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

Notes: 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 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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- Tax deferral maximization through contract element review
- Long-term construction contracts
- Alternative minimum tax planning
- 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

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

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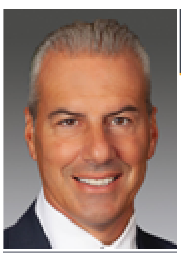
- Setting up client access to accounts
- Reviewing proof of claims and determining correct payments
- Looking beyond the payment required
- Writing and processing checks with signatures
- Identification of fraudulent and preferential transfers and payments
- Returning undistributed funds
- Accounting 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



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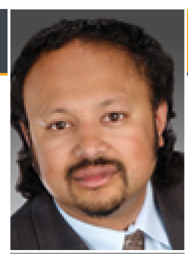
Joseph Natarelli is national leader of Marcum's Construction Industry Group and office managing partner in New Haven. For more than a decade, he has served as a technical reviewer for the AICPA's Audit Risk Alert for Construction Contractors and the AICPA Accounting Guide – Construction Contractors. 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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