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Diminished expectations? Will construction and RE development continue to improve in 2014?

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What a difference a year makes. In 2012, construction activity in the northeast exceeded \$72 billion; a 9.5% increase over 2011. The hope and expectation was that 2013 would be even better.

All of the signs were there. The unemployment rate continued to drop, inflation remained relatively low at 1.8%, and even though long term interest rates had increased, the average rate for 30 year fixed mortgages was still at a near record low.

Overall economic indicators showed that the U.S. economy was still struggling, however. Real GDP through March 2013 was 1.7%; well off the pace set in 2012 when real GDP increased 2.8%.

In addition, since the beginning of this year, the economy has been adversely impacted by the sequester, which may result in \$4 billion in construction spending cuts by the federal government. The construction industry received another blow in May when Federal Reserve chairman Ben Bernanke suggested that the Fed might cut back on its \$85 billion per month purchase of Treasury bonds and securities. Known as quantitative easing, the Fed's program kept interest rates, including mortgage rates, at record lows for the past several years. Following chairman Bernanke's announcement, the average 30 year fixed mortgage rate increased from 3.4% to 4.5%.

And the current gridlock in Washington and the specter of a government default looms over the U.S. economy - and the construction industry - like a darkening cloud. All of this economic uncertainty has forced many construction industry pundits to reconsider their projections.

What are the pundits saying about growth for the remainder of 2013 and into 2014? Current predictions are mixed. Business Monitor International, for example, has long predicted that the construction industry will experience average 4.5% growth year-on-year through 2018. Last December, the American Institute of Architects (AIA) Consensus Construction Forecast Panel projected a 5% increase in construction spending for 2013 and a 7.2% spending increase in 2014. The AIA's most recent prediction, however, is that 2013 construction spending will increase by only 2.3%, while 2014 spending will be slightly higher than AIA's earlier prediction at 7.6%.

McGraw Hill Construction foresees a 6% increase in total construction starts from 2012 to 2013. But that projection assumes that non-residential building construction, which was off to a slow start in the first half of this year, will gain some momentum. It is unclear whether non-residential construction has improved since the Census Bureau was unable to release new data for August as a result of the federal government shutdown.

There is some good news for several construction sectors in the northeast, however.

According to McGraw Hill Construction's mid-year predictions, single family housing starts in the Northeast are expected to rise 22% in 2013 over 2012 results. This is only 2% lower than the 24% projected national increase.

Commercial and manufacturing starts in the northeast are expected to follow a similar path. McGraw

Hill Construction projects an 11% increase in 2013, which is only 2% less than its projected national increase. On the national level, the AIA predicts that commercial and manufacturing spending will achieve low double digit growth for 2014.

For multi-family housing, McGraw Hill Construction's national and Northeast predictions diverge by a considerable margin. According to McGraw Hill Construction, multi-family housing in the Northeast is expected to increase 41% in 2013; over double McGraw Hill Construction's national projection. The huge growth in multi-family housing is expected to flatten out as this market matures, however. According to the AIA, the slowdown in housing starts will affect multi-family construction more than single family construction.

Also, according to McGraw Hill Construction, institutional construction, including education and health care, is expected to drop 5%, marking the fourth straight year this sector has fallen. Hospital and health care construction could likely be further impacted by cuts in Medicare payments and by the U.S. Supreme Court's decision to allow states to opt out of the expansion of Medicaid mandated by the Affordable Care Act.

If the U.S. economy continues to experience lackluster growth, growth in the construction sector will likely remain flat. However, construction industry growth projections could change significantly depending on what happens with the implementation of the Affordable Care Act, the continued downsizing of the U.S. government as a result of sequester and the impact to the U.S. economy resulting from the shutdown.

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