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## **Diminished expectations: Will construction and real estate development improve in 2011?**

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In early 2010, the conventional wisdom was that construction and real estate development would rebound. And with good reason - initially at least. The economy rose 3.7 percent and job growth continued through the first half of 2010. However, in the second half of 2010, growth sputtered as unemployment remained stuck at 9.5%, and housing starts declined precipitously once the first-time homebuyer credit program expired.

What are the prognosticators saying about 2011? Current predictions are mixed. Business Monitor International, for example, predicts that construction will average 4.5% growth year-on-year through 2018, while McGraw Hill Construction foresees an 8% increase in total construction starts in 2011 over 2010. Other prognosticators are less optimistic. The American Institute of Architects' Architectural Building Index continues to show a decline in the demand for design services and, according to the AIA, there is a nine-to-twelve month time lag between architectural design and construction spending. Thus, the AIA predicts a further decline in commercial real estate development in 2011.

There are also concerns expressed by other industry trade groups that public and private construction will remain static or even decline in 2011 for several reasons:

- \* American Recovery and Reinvestment Act stimulus programs will end this year;
- \* Real growth in the private sector will require that banks start construction and real estate development lending again;
- \* Recently enacted financial reform legislation may further restrain funding for CMBS loans which fueled commercial real estate development over the past decade.

In addition, over the next four years, approximately \$1.4 trillion in commercial real estate loans will mature. Current estimates are that approximately 50% of these loans are secured by real estate worth less than the loan amounts. Thus, there is uncertainty as to whether these loans will be extended or the mortgages securing those loans will go into foreclosure.

In comparison with other parts of the United States, the northeast may see higher construction spending in 2011, especially in the areas of single and multifamily housing, commercial office space, retail and health care construction.

According to McGraw Hill Construction, single family housing starts are expected to increase by 25% over 2010 results. A similar jump is expected in multifamily housing starts as investors shift to the more favorable income streams they believe will be generated from residential housing development. This growth is expected to be aided by the continued availability of low interest mortgage financing, easing standards for prime residential loans and a gradual rise in home prices. Commercial building construction is also expected to increase in the northeast by approximately 16% to over \$11 billion in 2011 as companies take advantage of relatively low labor and material

costs and low interest rates. Health care construction is expected to have a more modest 6% increase, but education-related construction is expected to decline by approximately 6%, largely due to the severe state and local funding cuts for educational facilities, and the declining endowments for private schools and universities. One "bright" segment - laboratory facilities construction - is expected to have a slower decline in 2011.

Retail construction in the northeast is expected to increase 19% over 2010 results as major retailers continue to expand into urban areas and discount chains like Dollar General, Family Dollar and Bed, Bath & Beyond are expected to build over 800 new stores. However, utility construction will decline an additional 10% in 2011 and, to the extent that nuclear power construction advocates were expecting resurgence in nuclear power spending after many years of stagnation, the recent nuclear reactor failures in Japan will likely delay any new initiatives.

Overall, it appears that the United States is slowly coming out of the steepest downturn in construction activity since 1945. The expectation and the hope is that 2011 will be the first of several years of renewed growth for overall new construction activity. This upward trend may stall or even reverse course, however, if unemployment remains static or increases and credit remains tight.

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