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Charles Reilly - Activity is strong, inventory of existing property is declining: July 2011 feels a lot better than July 2010

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The "new normal" seems to be a popular phrase these days as the commercial real estate market adjusts after hitting the bottom of this long cycle and is in the throes of turning positive. For design-builders and general contractors alike, the question is: Will the market return to that of 2005-2007 when ground-up construction of commercial facilities was a good percentage of one's deal flow? Today, eighty plus percent of commercial construction in New England markets is tenant improvement renovations. TI is the "new normal".

Inventory for mid-size to large manufacturing, warehouse, and distribution properties available for sale at twenty-five cents on the dollar of the replacement value cost has crushed the build-to-suit market. The only ground-up construction in the commercial market is for corporations expanding on existing sites, and the good news is those projects exist.

Developers and corporate users are picking off two-story office, R&D and flex properties trading in the $20 and $30 per s/f range, reducing inventory and creating base building upgrade project activity. Project size is trending smaller and includes base building upgrades to common areas, adding amenities for building services, health centers, cafeterias, and office tenant fit-ups to back-fill vacancies. Commercial brokers all claim they are having a good year to date with decent leasing and sale activity. Paranoia in the corporate suites has diminished and the expected pent-up demand for expansion seems to be materializing, although slowly.

The manufacturing sector has gained some momentum within the Rte. 495 belt with pricing and permitting activity occurring with four to six projects under construction or soon to be. Applications include corrugated manufacturing, cable assembly, synthetic tissue production, fire arms and wafer disc manufacturing. Distribution and logistics company expansions and limited warehouse expansions are occurring primarily as consolidation into bigger distribution centers; i.e. the former A. J. Wright distribution center of 500,000 s/f in Fall River and two major distribution centers in Devens are close to commitments. The South Coast market has seen a marked increase in leasing activity for logistics and food-related products, according to NAI Hunneman Commercial.

There has been and continues to be hiring within architectural firms, project management services and owner representative companies over the past six months. This demonstrates confidence in the long-term sustainability of this rebounding market and should lead to eventual hiring activity in construction management and general contracting companies. A recent Boston Business Journal article cited statistics still pointing to job loss within the construction sector, but it is this writer's belief that hiring will begin the third quarter of this year.

Construction pricing is stable with subcontractors working with their construction partners to keep pricing to existing levels, due to fierce competition on every project. Material costs have increased in the neighborhood of 5% to 7%, specifically copper, steel, and surcharges for fuel, but the market is adjusting to these increases by not passing along these increases or discounting at the bottom line.

In conclusion, getting deals into construction is still very challenging and takes a long time. However, activity is strong; inventory of existing property is declining; and July 2011 sure feels a lot better than July 2010. It is still a good time to build. Hopefully, we can improve the "new normal" over the next six months with a return to a more robust ground up construction market.

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