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The down side of the real estate construction boom

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In many ways, it's a great time to be in the commercial real estate business in the Boston market. Construction is booming like nowhere else in the country, interest rates are at historic lows and lenders are lending.

But challenges persist. The cost of both labor and materials is rising, and even if the budget is able to absorb rising costs, finding qualified labor is difficult.

Because of the real estate bust of 2008, many left the industry. Workers ranging from architects and engineers to electricians and construction workers were laid off and forced to find work in other industries. While some are returning, many resettled into their current jobs and have no desire to return to the cyclical construction industry.

Over the past couple of years, surveys of Boston-area architectural firms by DiCicco, Gulman & Co. LLP found that the industry was recovering, but that firms were still lean and had not rehired employees. This year, firms are adding staff again - and if there were more architects in the market, they would have no trouble finding jobs.

To date, architectural firms have been able to keep up with demand, but firms are poaching each other's talent and hiring fresh college graduates, even though they need more experienced talent.

As projects advance to the construction stage, the impact of the labor shortage on developers will grow. With fewer experienced workers and increasing demand for their talents, prices will naturally continue escalating. In addition to adding to the cost of construction, the labor shortage could cause a slowdown in many projects.

Likewise, demand for materials such as steel and cement is driving up prices to the point where developers are wondering whether they can make enough of a profit to make it worth taking the risk involved with construction projects.

Boston's Momentum

Regardless of these challenges, the construction boom is likely to keep developers busy for the next several years.

One reason is that Boston has momentum in its favor. Some projects that were ready to go before the financial collapse of 2008 are now moving forward - and they have created momentum for other projects. The multi-billion dollar Seaport project, in particular, has been a magnet for further development.

The development boom is even spreading beyond Boston and into its suburbs, with projects such as Nordblum's 3rd Ave., a retail walking street being built in Burlington, Mass., that will feature a public park surrounded by restaurants and cafes, as well as a 140,000 s/f Wegmans supermarket.

Developers are also anxious to jump back into the Boston market to be ahead of demand and to take advantage of current low interest rates. Ideally, developers would like to complete their projects

and lock in permanent financing at the lowest possible rates, so they were encouraged by The Federal Reserve Board's announcement that it expects to keep rates low through 2014.

The political climate is also in the developers' favor, as currently there are few obstacles to development. Given the current shortage of apartments, residential and mixed-use development is getting fast-track approval.

At the same time, there is little competition for investment, as other investments are yielding little return, so investors and developers are more willing to take on construction risk than they otherwise might be. Boston's robust real estate market is far more attractive, for example, than low-yield U.S. Treasury bills.

Boston's "med-ed" concentration is especially attractive to foreign investors. Where the Boston economy formerly was dependent on the computer industry, today its biggest draw is the healthcare industry, including not only hospitals and clinics, but biotechnology and medical device companies.

The healthcare industry is likely to thrive for many years, given that baby boomers have just begun to retire. The U.S. Census Bureau says there are more than 77 million baby boomers and the oldest boomers began retiring in 2011. As boomers continue to age, they will increase demand on healthcare services.

Retiring baby boomers will also spur additional labor shortages, which the Boston market can help fill because of its world-class colleges and universities. The city's financial services companies are another plus.

The current construction boom is likely to last for several years. It could last longer if the proposed expansion of Boston's convention center takes place. It could last longer still if the economy turns around and begins growing at a faster pace.

There is plenty of good news for property owners, developers and construction companies, in spite of today's challenges.

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