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Partly sunny with a chance of headwinds - A/E/C forecast - by Laureen Poulakis

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New England’s longest-lasting growth run continues and 2019 will be a year of uncertainty. What are the disruptor’s this year?

A/E/C: Rising construction costs that we thought were baked into Boston’s market in 2018 are expected to trend upward and supplier margins will pressurize further due to trade wars on the international stage. CBRE notes higher import prices coupled with a surge in wages could lead to inflationary pressure in 2019. Labor forces are participating above national trends, think low unemployment and solid job gains, but we are seeing droughts on skilled worker availability. According to NEPPC, 2018Q3 construction posted the largest year-over-year job growth rate across sectors in Mass. and New England. This is expected to slow through 2019. The Federal Open Market Committee predicted unemployment rates will bottom out sometime in 2019/2020 and begin to rise slightly. There aren’t enough people available and A/E/C companies have had to rethink expansion plans. Mergers, acquisitions and ESOPs remain a popular strategy for 2019.

FMI reports dips in TEV/EBITDA and NTM multiples began late in 2018 industry-wide for A/E/C and are anticipated to continue. GDP growth rate decline is predicted by several outlets through 2020. Massachusetts annual GDP rates were 5.9% in early 2018, have steadily dropped and predictions for 2019 include 2.7% from CBRE, 2.1% from FMI and 1.9% from the Congressional Budget Office. Increases in long term interest rates and bond rate hikes are likely while all eyes are on flattening yield curves, the first inversion in early Dec 2018 in a section of US Treasuries.

Markets: Downtown office space is in short supply and demands increase in 2019. Savilles and the Globe reported late 2018 office space availability rates dropped in Boston/Suffolk County to 9.7%, Boston Properties is at 3% of their downtown inventory, and class A asking rents rose by 1.5%. This trend will continue as the large-scale projects coming online are leased up by the time they are shovel-ready. While corporations are moving into the city, space limitations are driving life science, industrial and warehouse out of Boston. One fully-strained market is life sciences; demands for space continue with vacancies dropping steadily from 10% in 2016 to 5% in 2018. Life science rents have climbed more than 30% in three years and sale prices are breaking records at $1,000 per s/f. Record breaking absorption in industrial/warehouse, due to omni retail and speed-to-ship pressure in the supply chain, also shows no sign of slowing. E-commerce delivery, ride-hailing services like Uber and Lyft plus Boston's high-rise construction boom, are melding together to make transportation/infrastructure the newest programming challenge in real estate.

Hospitality will see above average supply growth in 2019 with 40 projects and 9,000 rooms in the pipeline for Boston/Cambridge according to BDPA. Pinnacle Q3 reports predict a 5.4% increase in supply and 3.7% increase in demand for the upcoming year. Developers and REITs have been capitalizing on these demands. Some speculate while consumer spending continues to increase, hotel owners will further raise room rates, making ADR an even bigger driver of RevPAR growth. 2019 will be a year of correction in Boston's residential market as the high water mark passed, housing production is constrained and rents are climbing. The large volume of new Class A rentals downtown saw urban cap rates at 3.5-4.75, thin risk premiums, and FMI reports slowing CPIP projections. Banks are entering the competition and according to the Federal Reserve, easing credit standards for the first time in years to compete with private lenders. Single family and condominium home buyers pumped the breaks in late 2018 and mortgage rates are predicted at 5.5% by end of 2019.

In all, 2019 will be the year to watch disruptors, re-evaluate risk and adjust.

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Sources: ULI, PwC, Savilles, NEPPC, CBRE, Pinnacle, FMI, Globe, Chartwell.