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## **From Sears, Roebuck & Co. to commercial real estate companies - many are considering modular for construction**

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Boston, MA Modular construction, long associated with “prefab” suburban subdivisions, has made enormous strides since its beginnings more than 100 years ago.

The process makes it possible to fabricate a structure from units that are created off-site and moved to a final location for assembly. Modular construction takes place under controlled conditions with tight specifications using the same materials and standards as conventionally built facilities. As opposed to stick-built construction, modules can be arranged side by side, end to end, or stacked, then joined together on-site to form the overall structure.

Because the units are produced in a different location than the actual building site, distance plays a major role when considering modular construction, as does the type of structure being designed.

Pioneered by companies such as Sears, Roebuck & Co. to serve the need for high-quality,

inexpensive residential “kit” homes throughout the 20th century, contemporary, sophisticated modular construction has begun to make significant inroads in the commercial development space. This is particularly true for projects such as mid-rise hotels and apartment complexes that are characterized by similar footprints and easily repeatable structures.

Though commercial use of modular is still in its relative infancy, according to the Modular Building Institute, an industry trade association, it has doubled in size to \$8 billion over the past five years. Moreover, a 2018 U.S. Chamber of Commerce report found that “half of all contractors using prefabricated and modular approaches expect to increase their use in the next three years,” with the largest demand in the hospitality, healthcare and manufacturing sectors.

As modular construction continues to grow in complexity and building materials evolve, there is little doubt that more commercial projects – both new construction and remodels – will use some form of modular construction. But developers looking to benefit from the advantages of modular construction should also understand its limitations and think carefully about how they finance such projects, as well as the partners they choose.

The execution of modular projects can be logistically and technically challenging, so selecting a contractor that has experience in constructing and installing modular components is critical. Similarly, from a financing perspective, it’s important to work with a lender that has experience in “structuring” modular deals, understands their nuances and can configure financing accordingly.

Why Go Modular? The advantages of modular construction can be numerous.

First, it can enable developers to use labor in a more efficient manner and better manage the project’s overall compensation structure, especially for projects in high-wage locations. 88 percent of contractors are concerned about skilled labor costs, while approximately 95% worry about whether workers have adequate skill levels, according to a 2019 U.S. Chamber of Commerce Commercial Construction Index report.

Second, assembling units off-site in a controlled environment can help mitigate weather delays.

Third, it can help projects get to market more quickly, with components being assembled off-site while on-site excavation and prep work is taking place. This enables more predictable timing and, potentially, a project that produces revenue more quickly. A recent study of modular construction in hospitality by JLL concluded that: “Although the technology has the potential to lower costs in the long term, the main benefit today is a significant decrease in development time.” Other studies have found that modular construction can substantially shorten development schedules, meaning that the occupancy stage can begin much sooner, accelerating return on investment.

Finally, given today’s growing focus on sustainability, modular construction can provide the added advantage of being “greener.” Even modular projects that do not use green materials tend to produce less waste and tend to be more easily recycled. Lower volumes of construction noise and vehicular pollution also may factor into the equation.

Despite its advantages, there are some pitfalls to modular construction, primarily a lack of flexibility. After materials choices are made and units built, implementing changes can be more costly than with traditional construction because components are meant to work in concert with one another. The lack of flexibility after ground is broken makes it imperative for developers to plan carefully.

Not every commercial project lends itself to a modular approach. High rise buildings are typically comprised of steel and concrete, which lend themselves less easily to being built modularly off-site. Mid-rise buildings, on the other hand, tend to be composed of a steel and concrete lower podium floor, with a stick/lumber framing above, or are completely stick built, depending on height. For a developer, the decision to use modular, part-modular or traditional construction comes down to an assessment of many factors – including material, labor and time – in light of total cost and project risk.

**Choose Experienced Partners:** For all their potential benefits, modular projects can be challenging, requiring careful design and forethought about how units are manufactured, assembled and transported. It is therefore important to work with a general contractor that can demonstrate previous experience with modular projects and can marshal the logistics necessary to execute the project on time and on budget. Fortunately, an increasing number of contractors specialize in this space.

Equally important is the choice of financial partner. The nature of modular projects dictates that lenders cannot structure loans in the same way that they do traditional ground-up projects. A typical commercial construction loan requires the lender to fund out of the loan for costs incurred for onsite work. But with modular projects, contracts often require payment upfront before a production cycle starts, as well as payments when items are shipped or arrive on site.

Developers should seek out lenders who are comfortable and willing to work with the numerous contracts that are involved in modular construction, can design the loan effectively and understand both the upsides and the risks of modular construction.

**Final Thoughts:** As the commercial real estate market continues to evolve, it is conceivable that ever-more ambitious projects will make use of modular techniques, either in whole or part. In the nearer term, however, the demand for modular solutions is most likely to escalate in lower- and mid-rise projects, particularly in multi-family and hospitality.

With developers, contractors and lenders gaining more experience with modular projects, the industry will continue to innovate, refine and better manage risks. For now, developers interested in exploring modular construction should be open to the advantages it can offer, but also remain clear-eyed about its potential drawbacks as well.

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