



nerej

There are always opportunities if one digs deep enough, is creative and willing to take the risk - by David O'Sullivan

October 28, 2022 - Spotlights



David O'Sullivan

We are in a season of change when it comes to the economy. Job reports are good, inflation is still persistently high, interest rates continue to climb and the stock market goes up and down like a seesaw but mostly down. This is an uncertain fall season. There seems to be no one opinion on where we are headed.

As a developer of real estate it is almost impossible to tell where the market is headed and that has created uncertainty with how to act. We see this with our clients where they are on the fence whether to move forward or mothball the project until things are more certain. There are many factors to consider such as construction costs, interest rates, market conditions etc. Many feel that although the overall economy is not in recession, the housing market is truly in one.

With 30-year mortgage rates steadily climbing and now at 7%, it's not surprising the NAHB Housing Market Index fell to 38 (with 100 best) in October, the 10th straight monthly decline, and outside of COVID, its worst level since August 2012. This reflects the sentiment nationwide and not necessarily the local market. The Boston area still has a strong demand for housing due to the nature of the area with strong job growth and no available land to build. Homes are staying on the market longer and developers with larger projects of multiple units to sell are dropping their prices. Inventory has increased as has time on market but some buyers are now priced out of the market due to interest rates. First-time mortgage applications are down 38.3% year-over-year and refi is down 85.9% year-over-year. Lastly, nationwide single-family starts are off 18.5% year-over-year, but less costly multifamily starts are up 17.6% year over year as builders focus on rentals.

Maybe it is better to focus on rental apartments. The rents have been steadily rising for years. But in Q3, that abruptly reversed. Even more surprisingly, net absorption was negative across the U.S. last quarter, which analysts attributed to renters hesitating in the face of inflation and recession fears. Also apartments face the same issues home buyers face with higher interest rates making projects harder to make viable. Vacancy rates in the Boston area remain at extreme lows but rents are softening. Tensions are running high in real estate as the Federal Reserve keeps raising interest rates, and a broader downturn could be on the horizon.

In our area there continues to be a shortage of properties to develop. It does not appear sellers of property are ready to drop their prices to help make projects viable in the face of higher borrowing costs, increased construction costs (some due to market forces and some because of increased regulations) and tightening zoning laws. Housing affordability is at a tipping point and many cities and towns are requiring ever higher percentages of affordable units in new developments further straining development budgets.

There are many projects in the development pipeline and demand in Boston area is strong for labs and somewhat for office space but how long that will last is anybody's guess. The U.S. logged two straight quarters of declining gross domestic product, often viewed as the technical definition of a recession. But jobs reports kept coming in above predictions month after month, indicating to many that the economy is strong. There is talk of a recession but some feel it will be small and short lived.

Then the consumer price index rose by 8.3% year-over-year in August, surprising economists who expected slowing inflation. Recession fears came roaring back. Anyone on recession watch this year may have whiplash.

So do you wait it out, move ahead or proceed with caution? Some are sitting on sidelines waiting for a drop in property values before purchasing parcels for development, others are going after smaller projects with less risk and faster turnaround times from start to finished development. Buyers targeting distressed assets for development are watching the storm clouds gather on the horizon and have their eyes on the office or retail properties. There will be deals to be had there in the next few years, some said with many being converted to other uses depending on market demand. It is an interesting time to be in the real estate industry but it is also a scary time. There are always opportunities if one digs deep enough, is creative and willing to take the risk.

David O'Sullivan, AIA, is the president of O'Sullivan Architects, Inc., Reading, Mass.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540