Mid-year – Where are we headed now? - by David O'Sullivan

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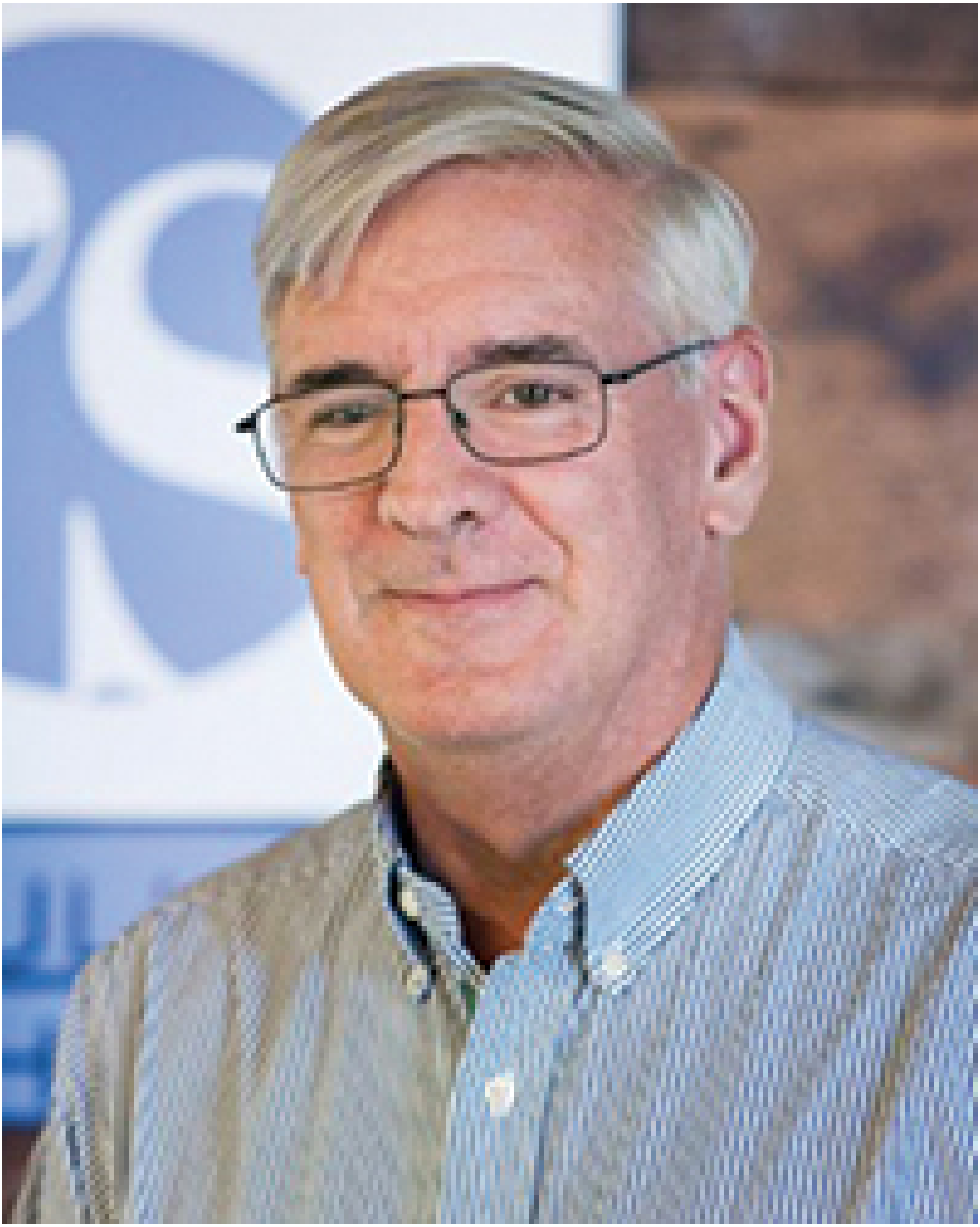

David O'Sullivan

It is now the middle of summer and many people's thoughts are about vacations, family time and enjoying the outdoors. But as business people we still need to keep on task with where trends may be headed in the real estate industry. In fact maybe vacation will be the time we can review those articles we have put aside to read later or a time to reflect on what we have accomplished in 2023 and do some soul searching for where we want to be at the end of 2023.

If nothing else the future seems to be uncertain. As the climate issues come more to the forefront and new regulations promoting alternative energy, more efficiency in our buildings and stricter codes, everything can seem to be changing faster than we can keep up with it.

Looking forward, there are several aspects to examine in the real estate industry. There is the residential sales market, rental market for both residential (great) and commercial (fair to poor), construction costs, code issues and more complex municipal approvals. Then of course there is the politics involving conflicting demands of providing more housing (especially affordable) vs. concerns of development as too dense. One cannot forget the banks with mortgage rates, development financing and tighter capital markets.

The big issue with the residential for sale market is inventory. Homeowners do not want to give up their low interest rate mortgage. This impacts homes available for new buyers and especially builders who can't get people to move up to the homes they are building. A recent blog by the Bowtie Economist which I read said this, "On March 31, 2023, 23.3% of home mortgages had a rate below 3%, 38% had a rate between 3%-4%, 19.9% had a rate between 4%-5%, and 18.8% enjoyed a rate over 5%. Equivalently, 61.3% of mortgages were below 4%, and 81.2% were below 5%. However, the percentage of mortgages below 4% peaked in 22Q1 at 65.3% as did the percentage below 5% at 85.6%. Both totals are down about 5% in 12 months." So if you don't have to give up your low-rate mortgage, to have a new one at rates approaching 7%, you are staying put.

The residential rental market is a different story. The vacancy rates remain low as more households are formed and due to lack of for-sale housing, demand is up. This means rents are steady or increasing. But this is good if you own rental property but there are challenges to develop and build new rental housing which are proving insurmountable. We are just starting to see the effects as new permits for residential rental housing are dropping. Many of the projects coming online now were started several years ago, had financing in place at lower rates and construction contract with lower cost. All these factors taken as a whole make developing new rental projects difficult to start and develop today. The commercial rental market is another aspect in total flux. Vacancies for office space are at record high levels, sub lease space on market is high and retail spaces remain empty. This is a subject for an article in itself.

Construction costs are playing an increasing negative factor in developments. The rise in costs of both labor and material, not to mention additional costs due to new regulations, has pushed many planned projects to the point they are not economically feasible. Our office has several shovel ready projects which are on hold or undergoing cost cutting measures to try to bring them back to economically feasible. If it is a rental, maybe rising rents help, but the for-sale projects are coming up dead in the water at this point.

Massachusetts has been passing new codes mandating ever more stringent energy requirements. The Massachusetts Homebuilders just completed a study with MIT and Wentworth outlining the challenges with meeting this code and its effect on construction cost. Check the HBRAMA website for more information. (www.hbrama.com). There is hope with some relief in the works when it comes to zoning and developing new housing in MBTA communities. The law which was passed a couple years ago promises to create an easier path through local zoning to develop new multi-family housing in communities with mass transit. This law is proving to be controversial in some towns but others are embracing the provisions as a means to help address the state's housing crisis.

Banks are in the news as well as what is happening with interest rates and their effects on businesses, consumers and development. The discussion about interest rates, inflation and will there be a soft landing or a recession hit us every day. There seems to be no consensus, just confusion. This makes it difficult, as a real estate developer to know how you should proceed on development project and what the future holds.

I wish I had a crystal ball to know what the next six months will bring but am thinking maybe I should take a vacation and read a good novel to stop worrying about it for a while.

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