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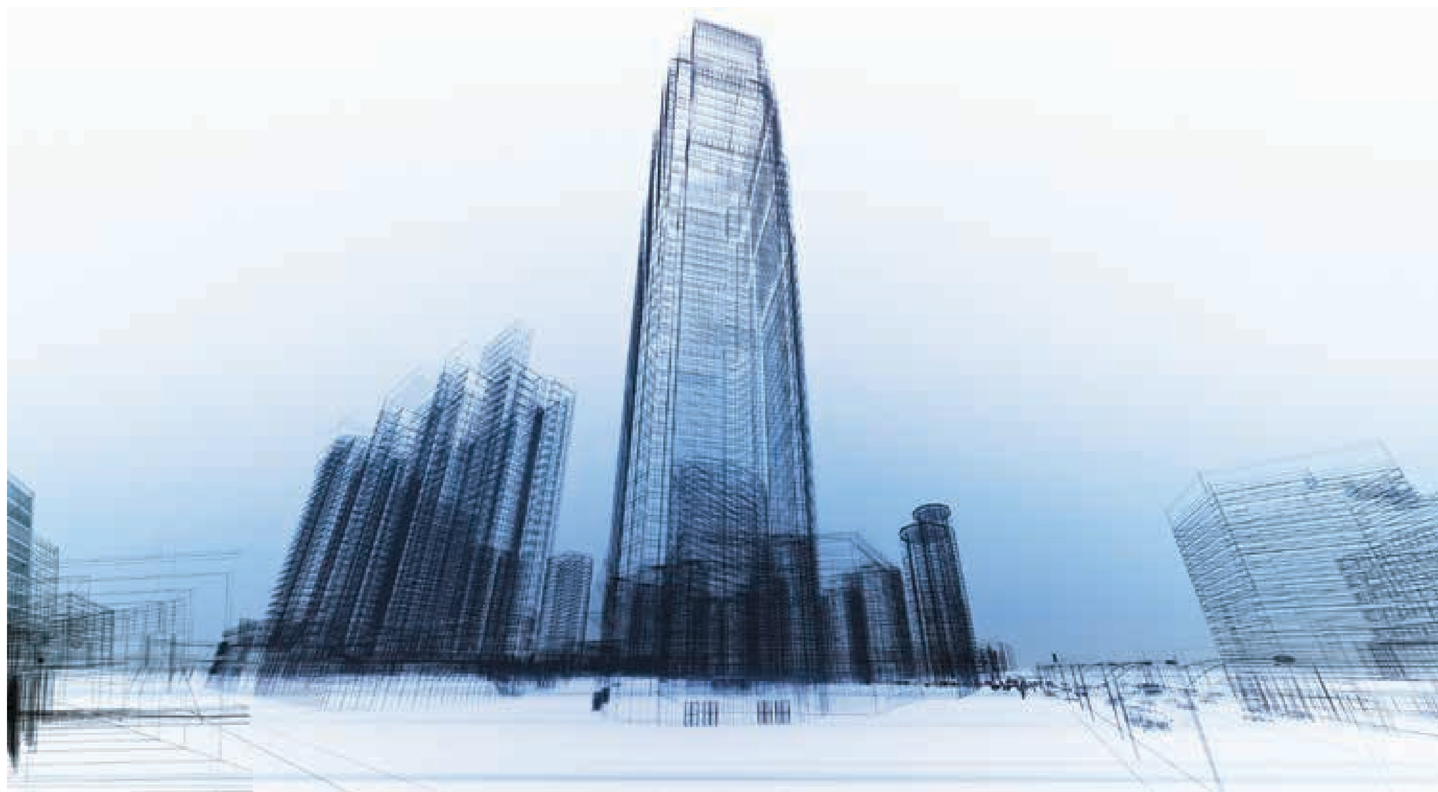

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# Construction state of play

*At least it's easier to build than in 2022!*

by Steve Bancroft, senior managing director, Trammell Crow Residential

As the U.S. economy tries to fend off a recession, the construction industry is feeling the effects of the interest rate hikes over the past year by the Federal Reserve. As a result, the start of new construction has declined, and while it is expected to be much easier to develop on time and on budget in 2023 than the previous year, there are still headwinds that are out of the control of the developer.

### Labor increases lag behind construction projects

As mentioned earlier, the U.S. is teetering on a recession, with experts debating a hard vs. soft landing, or even no landing at all. With that in mind, unemployment is still roughly 3 percent nationwide. And while the Federal Reserve is looking to raise rates with an end-game of 5 percent, the construction industry is well equipped and protected to weather the storm — more so than other industries — for at least 12–18 months, given the level of production across the country.

While multifamily construction starts are expected to drop by 50 percent in 2023, according to IPA research, there are still 1 million units under construction, which is an astonishing 33 percent higher than pre-

COVID levels. So, even if unemployment rises to 5 percent, there is so much product to build that it is hard to imagine the multifamily construction industry being materially impacted in the near term.

In addition, while units under construction represent a 33 percent increase compared with pre-COVID levels, the labor pool has not increased by that same amount. With the labor increase lagging behind construction project totals, this leads us to assume that the time period to actually build these projects will likely expand from 24 months, keeping construction professionals employed for longer than normal.

### Supply chain significantly improved from 2022

Regarding the availability and delivery of materials, we are in a much better position this year than we were in 2022, but there are still significant concerns that are difficult to mitigate for developers. During the peak of supply-chain woes, our company ordered and took delivery of almost all volatile materials, including lumber, and stored them in warehouses to get ahead of any anticipated shortages. On some projects, this accounted for more than $20 million in costs incurred early in the project that would sit in storage while development time lags. We do not believe this is necessary in 2023, given that the supply chain has returned to more normal levels, as evidenced by the cost of shipping containers returning to “pre-COVID” levels below $2,000, from a peak of above $22,000 in 2022.

Long lead-time items can also be problematic without the potential to effectively solve the issues. Electrical switch gear and transformers, for example, are ordered at the beginning of a given project, but can still cause costly delays for several months due to unavailability. These types of delays are unfortunately out of the control of the developer, and the only way to mitigate these types of logistical hurdles is to order as early as possible, even on day one, and communicate with the power companies weekly to ensure the squeaky wheel gets the grease.

### Best way to save costs: Preconstruction diligence and quality of plans

Simply put, a budget and schedule are only as good as the quality of plans and preconstruction diligence done by team members before the project is started. It is absolutely critical for pre-construction and development teams to attend every architectural and consultant meeting throughout the project and identify scope creep, plan adjustments, non-revenue space additions and potential value engineering to keep the budget in check.

However, we all know that budgets will increase and decrease at any given time based on a wide variety of factors. If a budget moves decidedly against the project, it is our goal to create lists of potential changes to the plans that would enable “zero-cost” budget impacts. In the early stages of a project, there is opportunity to save significant dollars on items that will not even be noticed once the project is built. These include civil capacities, height and structure of retaining walls, grades of the site, structural load capacity of buildings, number of cranes on site, duration and flow of construction, size and number of electrical transformers, and more. Millions can be saved, but you must take a microscope to these areas in the plans and aggressively manage the team of consultants. In the end, you get what you inspect, not what you expect.

***As we look to the next several months, amid the current economic environment and against the backdrop of rising rates and increased uncertainty, the construction industry has significant headwinds.***

As we look to the next several months, amid the current economic environment and against the backdrop of rising rates and increased uncertainty, the construction industry has significant headwinds. The increased cost of capital for new development has stalled most new starts in 2023. Apartment starts are forecasted to be half of 2022 for the next two years. For the construction industry to ensure a solid pipeline of starts in 2023 and 2024, costs of construction will need to decrease 10 percent or more in order for capital providers to receive the necessary returns to move forward on a project. So, the good news is that physically building apartments in 2023 will be an easier task than in 2022, but that needs to be coupled with the challenges of the increased cost of capital. This issue will slow the pace of new construction starts unless the industry can make the necessary steps to drive costs down across the board. ❖

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