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The \$40 Billion Question: Will Construction Costs Reach New Heights in 2016?

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CONSTRUCTION CONTINUES AT THE CITY POINT DEVELOPMENT IN BROOKLYN. (PHOTO CREDIT: MICHAEL NAGLE).

The New York Building Congress estimates that construction spending will reach new heights in the city this year.

“We do expect construction spending to hit \$41 billion,” said Michael Zetlin, a founding partner of Zetlin & De Chiara and general counsel for the New York Building Congress, “but that number covers all sectors in New York City.” There may be a slower escalation of construction spending this year as compared with previous years, he said, but the expectation to reach a record-high remains.

Still, with developers using nonunionized workers more than ever and the cost of materials holding steady, what is fueling the unabated splashing of cash?

The Building Congress expects non-residential developments to take the lead in the \$41 billion figure: A full \$11.5 billion will likely be spent on residential construction—down from \$14.9 billion in 2015—while nonresidential spending is expected to soar to \$15 billion, up from \$11.6 billion in 2015.

“When the residential projects that are 18 to 24 months out come online—or *if* there is a dip in the market—we can anticipate a slight reduction in construction spending. But where there is a slowdown in residential projects, other projects will certainly continue, such as the LaGuardia Airport Redevelopment Program and Hudson Yards,” said Mr. Zetlin, who has worked on both projects in the past.....

The struggle to reach a workable framework for 421a continues to be a hot topic in this regard and can only be reached in one of three ways, Mr. Coletti said. First, the cost of union labor has to be substantially reduced to make the financing viable. Second, the local government has to significantly increase incentives for developers. Third, the agreement should be limited to a certain number of units or scale. “If there is no 421a, there is no incentive to build affordable housing,” he said.

Until 421a is replaced by something else or reinstated, “I think we are going to see an essential stoppage of new projects looking for financing because none of it makes sense,” said Andrew Singer, the chairman and the chief executive officer of Singer Bassuk Organization. “You’ve paid too much for your land, it made sense when you were getting 421a benefits. Costs are high because the contractors are so fully engaged that they can quote prices that are extraordinarily high, because they’re not really looking for work right now. They’ve got work,” he said.

Separately, contractors are feeling the slowdown in accounts receivable. “Cash flow is the worst I have seen in 30 years,” Mr. Coletti said. In public projects, he explained, bureaucratic processes and change orders greatly slow the processing of payments, and “the procurement process itself just buries you.”

In contrast, Mr. Coletti said the projects he is personally excited about are those that Gov. Andrew Cuomo is aggressively moving forward with, namely the Javits Center and Pennsylvania Station design-build projects. “They are cost-effective and take way less time to execute,” he said.

New York City will always be a unique animal, standing head and shoulders (or stories and spires) above other urban cities in terms of construction costs. The crux of the matter is that development projects in New York City are undertaken in the “densest, most complex urban environment in the world,” Mr. Coletti said. Construction costs in New York can involve street closures, building permits and expensive safety precautions to minimize risk. Due to the over-populated nature of the city, any project automatically creates a public risk.

Another significant outlay added to construction costs in the city is the exorbitant insurance required, due to the “Scaffold Law.” Scaffold Law was enacted in 1885 in a bid to protect construction workers from the increased risk they faced while creating the dizzying heights of New York City’s skyline. The 131-year-old law imposes “absolute liability” on contractors and property owners engaged in construction, repair or demolition work for any elevation-related injuries experienced by workers, while employees are absolved of all responsibility for their part in incidents. It has a tremendous impact on construction costs across the city. The cost of insuring construction projects in New York City can be as much as 10 times higher than other states as a direct result of Scaffold Law.

“Scaffold Law keeps insurance costs high, because of the strict liability standard,” Mr. Coletti said. “If a worker gets hurt on the job, it’s 100 percent paid for by the contractor. There is no way to show the employee contribution to the incident. It’s a fight we have been fighting for 30 years now. We made significant progress two years ago—the governor understood the problem and was supportive of efforts to try to change it. But everything stopped because of the opposition from the trial attorneys and the unions.” As a result of Scaffold Law, many insurance companies won’t offer general liability insurance. If the law was reformed to a fairer comparative standard, in which a jury would be presented with the facts of an incident and then decide who was at fault, excessively inflated insurance costs would be dramatically reduced, Mr. Coletti said.

While the cost of construction is seemingly on an upward trajectory, development contrarily is beginning to decelerate.

“We’re coming off three or four years of a very heavy development cycle,” said Michael Maturo, the president and chief financial officer of RXR Realty (see the Q&A with Mr. Maturo on page 58). “I don’t think development will stop. I think it’ll slow, but I think it’ll still be brisk. I think things like super high-end condominiums will slow very dramatically, but I think there still will be development of rentals even in the boroughs—but certainly at a slower pace. I think land prices accelerated, and I think you’re going to see a natural downward movement just to get back to a normal acceleration in the cycle. You had acceleration, acceleration and now that pendulum needs to swing back a little bit.”

Only time will tell what the impact of that pendulum swinging back will have on the inordinate costs of construction in New York City. In the meantime, those who expect to build and contribute to the city’s architecture can expect to pay out the big bucks for the privilege.

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